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No.

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In The Supreme Court of the United States October Term, 1990

EDWARD F. BAGDON,
Petitioner,

v.

THE FIRESTONE TIRE AND RUBBER COMPANY,
Respondent.

PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT

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QUESTIONS PRESENTED

(a) Whether the Court of Appeals created a conflict with decisions of this Court by ignoring this Court's mandate to apply Federal Rule of Civil Procedure 19 pragmatically.

(b) Whether the Court of Appeals created a split among the Circuits by failing to apply the appropriate "abuse of discretion" standard of review to the District Court's determination under Fed.R.Civ.P.19 that the parties' corporation was not a necessary party.

(c) Whether the Court of Appeals overstepped its jurisdiction by making an improper finding of fact as to when the state of incorporation of the parties' corporation changed — an issue which was factually disputed by the parties and never addressed by the District Court.

(d) Whether the Court of Appeals violated the *Erie* doctrine in this diversity action by failing to follow state law which clearly recognized that plaintiff's claims were individual and not derivative.

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PETITION FOR A WRIT OF CERTIORARI
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Petitioner respectfully requests that a Writ of Certiorari issue to review the decision and judgment of the United States Court of Appeals for the Seventh Circuit, entered on October 17, 1990. The Seventh Circuit vacated and remanded a decision of the United States District Court for the Northern District of Illinois which had entered judgment on a jury verdict in Petitioner's favor.

OPINION BELOW

The opinion of the Seventh Circuit is officially reported at 916 F.2d. 379 (a copy of the opinion is attached in the Appendix, p. 1a). The memorandum opinion and order of the District Court denying Respondent's motion to dismiss for failure to join a necessary party is reported at 1987 WL 18353, 1987 U.S. Dist. LEXIS 9395 (Appendix, pp. 14a-19a). The District Court's memorandum opinion and order denying Respondent's Motion for Summary Judgment is reported at 1989 WL 24492, 1989 U.S. Dist. LEXIS 2607 (Appendix, p. 20a).

JURISDICTION OF THIS COURT

Judgment was entered by the Court of Appeals for the Seventh Circuit on October 17, 1990. (Appendix, p. 12a) Petitioner's Petition for Rehearing and Suggestion for Rehearing *en banc* were denied on November 13, 1990. (Appendix, p. 13a) This Court has jurisdiction pursuant to 28 U.S.C. §1254(1). Jurisdiction in the District Court below was based on 28 U.S.C. §1332.

STATUTE INVOLVED

This case involves Rule 19 of the Federal Rules of Civil Procedure, which provides:

RULE 19. Joinder of Persons Needed for Just Adjudication

(a) **Persons to Be Joined if Feasible.** A person who is subject to service of process and whose joinder will not deprive the court of jurisdiction over the subject matter of the action shall be joined as a party in the action if

(1) in the person's absence complete relief cannot be accorded among those already parties, or

(2) the person claims an interest relating to the subject of the action and is so situated that the disposition of the action in that person's absence may

(i) as a practical matter impair or impede the person's ability to protect the interest or

(ii) leave any of the persons already parties subject to substantial risk of incurring double, multiple, or otherwise inconsistent obligations by reason of the claimed interest. If the person has not been so joined, the court shall order that the person be made a party. If the person should join as a plaintiff but refuses to do so, the person may be made a defendant, or, in a proper case, an involuntary plaintiff. If the joined party objects to venue and joinder of that party would render the venue of the action improper, that party shall be dismissed from the action.

(b) **Determination by Court Whenever Joinder not Feasible.** If a person as described in subdivision (a)(1)-(2) hereof cannot be made a party, the court shall determine whether in equity and good conscience the action should proceed among the parties before it, or should be dismissed, the absent person being thus regarded as indispensable. The factors to be considered by the court include: first, to what extent a judgment rendered in the person's absence might be prejudicial to the person or those already parties; second, the extent to which, by protective provisions in the judgment, by the shaping of relief, or other measures, the prejudice can be lessened or avoided; third, whether a judgment rendered in the person's absence will be adequate; fourth, whether the plaintiff will have an adequate remedy if the action is dismissed for nonjoinder.

(c) **Pleading Reasons for Nonjoinder.** A pleading asserting a claim for relief shall state the names, if known to the pleader, of any persons as described in subdivision (a)(1)-(2) hereof who are not joined, and the reasons why they are not joined.

(d) **Exception of Class Actions.** This rule is subject to the provisions of Rule 23.

STATEMENT OF THE CASE

1. Procedural History of the Case.

In 1987, petitioner, Edward Bagdon ("Bagdon"), the 49% shareholder in a close corporation, brought the instant lawsuit under diversity jurisdiction against the 51% shareholder, respondent, Firestone Tire & Rubber Co., now known as Bridgestone/Firestone, Inc. ("Firestone"). Bagdon alleged breach of the fiduciary duties of loyalty, good faith and fair dealing owed by a majority shareholder to a minority shareholder in a close corporation (Count I). He also alleged fraud (Count II) and violation of the Illinois Consumer Fraud and Deceptive Trade Practices Act (Count III).

Firestone moved to dismiss for failure to join the parties' close corporation (whose presence would have destroyed diversity) as an indispensable party. The District Court applied Federal

Rule of Civil Procedure 19 ("FRCP 19") pragmatically and denied the motion because the presence of the corporation added nothing to the suit and because Bagdon was asserting individual claims. (Appendix, p. 14a) After Firestone's subsequent motion for summary judgment was also denied, a three week jury trial ensued. At the close of all the evidence, the District Court directed a verdict on Counts II and III, but submitted Count I (breach of fiduciary duties) to the jury. The jury awarded Bagdon $912,636 (later remitted to $306,995) and judgment was entered on the verdict. In its post trial motion, respondent renewed its motion to dismiss under FRCP 19, but the motion was denied.

Both sides appealed. On appeal, the Seventh Circuit vacated the judgment in favor of petitioner and ordered the case dismissed because it found that the parties' close corporation was an indispensable party whose joinder would destroy diversity.

A Writ of Certiorari is sought because the Seventh Circuit: (1) flatly contravened this Court's clear and settled directive that FRCP 19 *must* be applied pragmatically in *all* cases, holding instead that "Rule 19 is *not* 'applied pragmatically' in derivative cases" (916 F. 2d at 382, Appendix, p. 6a) (emphasis in original); (2) created a split of authority among the Circuits by ignoring the abuse of discretion standard of review adopted in other decisons of the Seventh Circuit and other Circuits; (3) made an improper finding of fact, upon which it based its choice of law determination that Delaware law governed Firestone's fiduciary duties; and (4) refused to follow existing state law in determining that petitioner's claims were derivative, not individual in nature.

2. The Factual History of the Case.

Bagdon was the 49% shareholder and Firestone the 51% shareholder in a close corporation, Firestone Stores of Chicago-Ford, Inc. ("Chicago-Ford, Inc."). Chicago-Ford, Inc. was incorporated under Illinois law in 1971 to operate what was then the only Firestone store in the Ford City Shopping Center in Chicago. The store sold tires, automotive accessories and automotive service under the name "Firestone". At that time, there were three kinds of Firestone stores: (1) company stores wholly owned and operated by Firestone itself; (2) "M&M" stores owned and operated by a separate close corporation in which

Firestone was the majority shareholder and a store manager like Bagdon the minority shareholder; and (3) "dealer stores" owned by independent (i.e., not Firestone employees) dealers who were not granted exclusive territories by Firestone. Chicago-Ford, Inc., operated an M&M store.

In 1983, Firestone acquired J.C. Penney's automotive service facilities nationwide. Penney's had operated a facility in the Ford City Shopping Center. Firestone decided to open that store as a virtually identical, company-owned Firestone store to compete directly with the store it operated with Bagdon, even though:

(1) the two Firestone stores were located only 700 yards apart in the same shopping center;

(2) Firestone's own feasibility studies determined that the two stores in the Ford City Shopping Center were "too close . . . for both to be operated successfully . . . .";

(3) Firestone's field personnel recommended that it would be best for all concerned if Bagdon ran both stores;

(4) Firestone knew from past experience that putting its stores too close together would result in "cannibalization," in which the new store draws away the most profitable sales of the other store;

(5) Firestone did not open a Firestone store in every Penney facility it acquired, but instead decided to shut some down and lease them for non-automotive purposes because of their close proximity to existing Firestone stores;

(6) in *every* case where a former Penney facility was near a Firestone store owned by an independent *dealer*, Firestone offered the new facility to the dealer (though dealers, like M&M stores, were not given exclusive territories) because Firestone felt that to do otherwise would hurt the dealer and might cause

him to leave and become a dealer for another tire company;

(7) Firestone admittedly would have offered the new store to Bagdon had he been a dealer but it knew that Bagdon (unlike a dealer) could not leave Firestone if his business was hurt by a competing Firestone store because of a noncompetition provision in his shareholder's agreement; and

(8) Firestone admittedly owed Bagdon, as the minority shareholder, heightened fiduciary duties similar to those owed by partners in a partnership.

When Bagdon complained about a new Firestone store in such close proximity, Firestone told him not to worry, that Firestone would not hurt him and that he would run the new facility. Firestone thereupon treated Bagdon as the manager of the new facility, having him recruit new personnel and help set up the new facility. Firestone never told Bagdon until days before the new store opened that it had already decided months before that he would not be allowed to run the new facility.

Also in 1983, after 12 years as an Illinois corporation, Firestone decided to change Chicago-Ford, Inc.'s state of incorporation to Delaware. This change became effective August 15, 1983, well *after* the wrongdoing complained of by Bagdon. Firestone never told Bagdon that changing the state of incorporation could limit his rights or remedies as a minority shareholder. After changing the state of incorporation, Firestone eliminated the Board of Directors.

REASONS FOR GRANTING THE PETITION

I. The Court of Appeals Created a Conflict With The Decisions of This Court By Ignoring This Court's Mandate To Apply Rule 19 Pragmatically.

In reversing the District Court's determination that the parties' corporation was not an indispensable party, the Seventh Circuit explicitly held that "Rule 19 is *not* 'applied pragmatically'

in derivative cases." (916 F.2d at 382, Appendix, p. 6a) (emphasis in original). However, that holding plainly contravenes this Court's mandate and hornbook law that FRCP 19 *is* to be applied pragmatically in *all cases*, derivative or not. *Provident Tradesmen Bank v. Patterson*, 390 U.S. 102, 107, 88 S. Ct. 733, 19 L.Ed. 2d 936 (1968); C. Wright, A. Miller and M Kane, *Federal Practice and Procedure: Civil 2d*, §1601, p. 15 (1986). Indeed, this Court has specifically held that:

> [t]he decision whether to dismiss (i.e., the decision whether the person missing is "indispensable") must be based on factors varying with the different cases, some such factors being substantive, some procedural, some compelling by themselves, and some subject to balancing against opposing interests. Rule 19 does not prevent the assertion of compelling substantive interests; it merely commands the courts to examine each controversy to make sure that the interests really exist.

390 U.S. at 118-19.

Aside from the fact that petitioner's claims were not in fact derivative, the Seventh Circuit's inflexible approach is identical to that improvidently advanced by the Court of Appeals in *Provident Tradesmen Bank*. There, the Circuit Court likewise held that "there is a category of persons called 'indispensable parties' [and] that category is defined by substantive law and the definition cannot be modified by rule . . ." 390 U.S. at 118. This Court flatly reversed on the ground that FRCP 19 was revised in 1966 to *avoid* such inflexible approaches. 390 U.S. at 106-07.

But the Seventh Circuit, ignoring the District Court as well as this Court, did not even mention *Provident Tradesmen Bank* or the factors listed in FRCP 19, let alone pragmatically examine the controversy to determine whether Bagdon's claims (even if derivative) could have been adjudicated without the corporation (as such claims have been litigated in numerous other cases). Nor did it make certain, as it was required to do, that the interests allegedly requiring dismissal really existed. Instead, by creating a category of persons which it found would always be indispensable parties, it applied the very same formalistic

approach specifically rejected by this Court in *Provident Tradesmen Bank*.

Moreover, the Seventh Circuit's inflexible rule that the corporation is "always" a necessary party in derivative actions is wrong as a matter of law. The only authority cited by the Seventh Circuit for its inflexible rule were 1873 and 1947 cases decided well before *Provident Tradesmen Bank* and the 1966 revision of FRCP 19.[1] No court has held that simply by labeling an action as derivative in nature, the pragmatic, considerations listed in FRCP 19 can thereby be ignored. It is certainly *not* the law of Delaware (which the Seventh Circuit held governed petitioner's claims) that the corporation is always a necessary party in a derivative action. To the contrary, the Seventh Circuit misstated Delaware law in order to support its suggestion that such an inflexible rule exists. Contrary to the Seventh Circuit's stated belief, the court in *Taormina v. Taormina Corp.*, 32 Del. Ch. 18, 78 A.2d 473 (1951) explicitly recognized that Delaware *would* allow a minority shareholder to bring derivative claims individually where, as here, manifest injustice would result or the corporation's rights would not be protected otherwise[2] *Id.* at 475.

Delaware law is consistent with the law in the numerous other jurisdictions which recognize that, because close

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[1] The cited cases were *Davenport v. Dows*, 85 U.S. (18 Wall.) 626 (1873) and *Koster v. (American) Lumbermans Mutual Casualty Co.*, 330 U.S. 518, 522-23 n.2 (1947). In *Davenport*, this Court held that the corporation should have been joined because "[t]he relief asked [was] on behalf of the corporation, not the individual shareholder . . . ." 85 U.S. (18 Wall.) 626 (1873). That is *not* the case here; petitioner sought relief only from respondent on his own behalf and not on behalf of the corporation. *Koster* did *not* cite *Davenport* for the proposition that the corporation must always be joined in a derivative action.

[2] Moreover, the Delaware court in *Taormina* did *not* "require" the plaintiff minority shareholders to bring a derivative claim (as stated by the Seventh Circuit), they had already chosen to do so. 78 A.2d at 476-77. Nor did the court in *Abelow v. Symonds*, 38 Del. Ch. 572, 156 A.2d 416 (1959) require the minority to sue derivatively, as the Seventh Circuit stated. The *Abelow* court in fact held that the minority shareholders could sue *individually* on their claim that the majority shareholder profited at their expense from the dissolution of the parties' corporation. 156 A.2d at 420.

corporations really operate more like partnerships[3] than publicly-held corporations, and because majority shareholders owe heightened fiduciary duties to the minority shareholders, there is no reason to require that a minority shareholder in such corporation join the corporation (i.e., proceed derivatively) in order to bring a claim against the majority where, as here (1) the corporation's interests are represented by the parties to the litigation; (2) no third party would be affected by the suit; (3) the minority shareholder is the one most directly impacted by the majority shareholder's breach; and (4) a recovery by the corporation would allow the majority shareholder to benefit from its wrongdoings. *See e.g., Borak v. J. I. Case Co.*, 317 F.2d 838, 845 (7th Cir. 1963); *Watson v. Button*, 235 F. 2d 235 (9th Cir. 1956); *Kirk v. First National Bank of Columbus*, 439 F. Supp. 1141 (M.D. Ga. 1977); *Johnson v. Gilbert*, 127 Ariz. 410, 621 P. 2d 91[illegible] (1980); *Smith v. Tele-Communication Inc.*, 134 Cal. App. 3d 338, 184 Cal. Rptr. 571 (1982); *Yanow v. Teal Industries, Inc.*, 178 Conn. 263, 422 A. 2d 311 (1979); *Donahue v. Rodd Electrotype Co.*, 367 Mass. 578, 328 N.E.2d 505 (1975); *Crosby v. Beam*, 47 Ohio St. 3d 105, 548 N.E. 2d 217 (1989).

In short, the Seventh Circuit overlooked or ignored the fact that none of the rationales for requiring a derivative action are present here. Surely, for example, Firestone could not be subject to multiple suits; the only two stockholders were already involved in the litigation and no other person could be affected by the litigation. *Kirk v. First National Bank of Columbus*, 439 F. Supp. 1141, 1148-49 (M.D. Ga. 1977), 12B Fletcher, *Cyc. Corp.* §5924.10. Even the Seventh Circuit recognized that Bagdon was *not* just a shareholder injured solely in the value of his stock who will be fully compensated through the corporation's recovery — the other reason commonly offered for requiring derivative actions. (916 F. 2d at 381, Appendix, pp. 4a-5a) Here, recovery by the corporation in a derivative action would *not* compensate Bagdon for lost bonuses and salary; nor would it compensate him for the breaches of fiduciary duties which the law recognizes were owed by Firestone directly to him. A derivative action here would allow Firestone to benefit from its own wrongdoing through its

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[3] This is especially true here where the close corporation does not even have a Board of Directors and was managed by the two shareholders.

pro rata share of the recovery. To say the least, that would not be an effective remedy. *Crosby*, 548 N.E. 2d at 221. The Seventh Circuit's ruling was truly a triumph of form over substance. For this reason, it should not be permitted to stand.

II. The Seventh Circuit Created a Conflict Among The Circuits By Not Applying The Appropriate Standard of Review.

A related, but separate, basis for Certiorari is that the Seventh Circuit's decision creates a split of authority among the Circuits as to the appropriate standard for reviewing a District Court's Rule 19 determination. Every other circuit which has decided the issue has explicitly or implicitly adopted the abuse of discretion standard, *See e.g., Travelers Indemnity Co. v. Dingwell*, 884 F. 2d 629, 635 (1st Cir. 1989); *Cloverleaf Standardbred Owners Association, Inc. v. National Bank of Washington*, 699 F.2d 1274, 1276-77 (D.C. Cir. 1983) and cases cited therein. Under the abuse of discretion standard, unless the District Court has made a serious error of judgment which no reasonable person could agree with, the Appellate Court will not reverse. *Deitchman v. E.R. Squibb & Sons, Inc.*, 740 F. 2d 556 (7th Cir. 1984). No circuit has ever explicitly reviewed a FRCP 19 determination under the *de novo* standard used by the Seventh Circuit here. *Dingwell*, 884 F. 2d at 635. Indeed, the Seventh Circuit's *de novo* review in this case is not even consistent with its own prior decisions, *Pasco International Limited v. Stenograph Corp.*, 637 F. 2d 496, 505-6 n. 22 (7th Cir. 1980) and *Hansen v. People's Bank of Bloomington*, 594 F. 2d 1149, 1150 (7th Cir. 1979).

The reasons for adopting an abuse of discretion standard are that:

> Rule 19(b) determinations must be based on fact-specific considerations. These determinations are anything but pure legal conclusions. They are not based on "the technical or abstract character of the rights or obligations of the persons whose joinder (is) in question." Instead, they involve the balancing of competing interests and must be steeped in "pragmatic considerations." The district court, which is "closer to

> the arena," is in the preferred position to make these decisions.

Dingwell, 884 F.2d at 635 (citations omitted). Had the Seventh Circuit applied the abuse of discretion standard of review, it necessarily would have found that the District Court properly exercised its discretion when it twice considered Firestone's FRCP 19 argument and twice rejected it.

The District Court issued a lengthy opinion applying FRCP 19 pragmatically, as mandated by this Court in *Provident Tradesmen Bank*. (Appendix, p. 14a) The District Court considered four overlapping factors which, under FRCP 19(b), govern the determination whether one is an indispensable party. These are (1) whether the absent person's interests would be adversely affected by the litigation; (2) the extent to which the prejudice could be lessened or avoided by the shaping of relief; (3) whether adequate relief can be accorded among the parties joined without the presence of the absent party; and (4) the availability of an alternative forum. (Appendix, pp. 16a-19a).

Considering the first factor, the District Court found that the parties' corporation would not be adversely affected by this suit because no relief was sought against it. However, the Seventh Circuit never even examined the question whether the corporation would be adversely affected if the litigation proceeded in its absence. The mere possibility of prejudice (even if it existed here) is not enough. 3A *Moore's Federal Practice*, ¶19.07 [2. - 1] at 19-107 (1990). Indeed, as the District Court found, there was no need to join the corporation here, even if it could have been bound by the judgment, since its interests were adequately represented by the parties present. *Pujol v. Shearson American Express, Inc.*, 877 F. 2d 132 (1st Cir. 1989); 3A *Moore's Federal Practice*, ¶19.07 [2. - 1] at 19-106 (1990). This Court has held that where, as here, the merits of a cause can be determined without prejudice to the rights of any absent necessary parties, the court will "strain hard to reach that result." *Bourdieu v. Pacific Western Oil Co.*, 299 U.S. 65, 70-71 (1936).

Even assuming, *arguendo*, that some portions of petitioner's claims were individual in nature and some were derivative (which was not the case), any possible prejudice to the corporation could

have been easily avoided by shaping the relief – i.e., allowing petitioner to recover on his individual claims. *Greenspan v. Del. E. Webb. Corp.*, 634 F. 2d 1204 (9th Cir. 1980). But the Seventh Circuit did not even consider this second factor, although mandated by FRCP 19.

The third FRCP 19 factor also militated against a holding that the corporation was a necessary party. Here, unlike the cases cited by the Court of Appeals, petitioner never sought recovery from or on behalf of the corporation. Rather, Bagdon sought to impose liability on Firestone *alone* - based upon *its* breaches of fiduciary duties it *owed him* individually and its misrepresentations to him alone. (See Section IV, *infra*) The fact that Firestone also breached fiduciary duties owed to the corporation does not render Bagdon's claims any less individual in nature. Under the third Rule 19(b) factor, the District Court properly found that complete relief would be accorded among the parties already joined, in the absence of the corporation, since a damage award against Firestone did not require the presence of the parties' corporation in any respect. *Pasco*, 637 F.2d at 501. The Seventh Circuit improperly reversed without even mentioning this factor.

Not did fourth factor support the Seventh Circuit here. That court itself has held that the mere availability of an alternate state forum does not compel the joinder of a party whose presence would destroy diversity in view of the strong interest protecting a plaintiff's choice of the federal forum granted by federal law. *See e.g., Bonnet v. Trustees of Schools*, 563 F.2d 831, 833 (7th Cir. 1977). Indeed, the Seventh Circuit itself recognized that it is "highly inappropriate to dismiss when diversity jurisdiction is actually present," as it was here. *Hoefferle Truck Sales, Inc. v. Divco-Wayne Corp.*, 523 F.2d 543, 549 (7th Cir. 1975). Therefore, had the Court of Appeals applied the "abuse of discretion" standard of review here, as it should have, it could not have found that the District Court abused its discretion.

III. The Seventh Circuit Made Fundamental Errors In Applying Illinois' Choice-Of Law Rules.

In applying Illinois choice of law rules in order to determine which state's law governed petitioner's breach of fiduciary duty

claims, the Seventh Circuit abused *its* discretion and exceeded its appellate jurisdiction.

A. The Seventh Circuit Should Have Applied Illinois Law, Because Illinois Has The Most Significant Contracts With The Litigation

Quite simply, the Seventh Circuit misapplied Illinois choice of law principles in holding that Delaware law should be applied because the parties' corporation is incorporated there today. (916 F.2d at 382, Appendix, p. 7a).

The Seventh Circuit applied the general choice of law rule in Illinois which looks first to the law of the state of incorporation in matters of corporate governance. However, by doing so without examining the controversy thoroughly and pragmatically, the Seventh Circuit overlooked the well-established exception to the general rule set forth in Restatement (Second) of Conflicts of Law §306 (1971 and 1986 Suppl.) and adopted by the Third, Fifth and Tenth Circuits.[4] Under this exception, where only the "naked fact of incorporation" is located in the state of incorporation, the court should apply the law of the state which has the most significant contacts with the parties and the litigation. *Mansfield*, 268 F.2d at 321.

Clearly, the Illinois Supreme Court would adopt the well reasoned Restatement approach because it is consistent with the Illinois cases citing the general rule and the trend in Illinois away from mechanical choice of law rules and toward a more reasoned analysis of the relevant contacts. *See e.g., Ingersoll v. Klein*, 46 Ill. 2d 42, 48 (1973) (abandoning *lex loci delicti* test in favor of the Restatement's "significant relationship" approach).

Nothing connects this case with Delaware (other than the bare fact that respondent changed the corporation's state of incorporation to Delaware *after* it had breached its fiduciary duties to petitioner) while everything connects it with Illinois

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[4] *Mansfield Hardwood Lumber Co. v. Johnson*, 268 F.2d 317, 321 (5th Cir. 1959), *cert. denied*, 361 U.S. 885 (1959). *See also Kohn v. American Metal Climax*, 458 F. 2d 255 (3rd Cir. 1972), *cert. denied*, 409 U.S. 874; *Blazer v. Black*, 196 F.2d 139 (10th Cir. 1952).

(where all relevant events took place, where Bagdon resides and where the close corporation has its principal place of business). The Seventh Circuit should have applied Illinois law, not Delaware law, had it complied with its obligations under the *Erie* doctrine to apply the rule that Illinois Supreme Court would adopt if the issue were presented. *Erie Railroad Co. v. Tompkins*, 304 U.S. 64 (1938); *White v. United States*, 680 F.2d 1156, 1161 (7th Cir. 1982).

B. The Seventh Circuit Erroneously Applied Delaware Law Even Through the Parties' Corporation Was Incorporated In Illinois When Respondent Breached Its Fiduciary Duties.

However, even applying the general choice of law rule which looks solely to the law of the state of incorporation, the Seventh Circuit's application of Delaware law was fundamentally wrong. The court should have looked to the law at the time the relevant events occurred, not the law at the time the suit was brought. *Robak v. United States*, 658 F. 2d 471 (7th Cir. 1981). The Seventh Circuit overlooked that the corporation was an Illinois corporation, *not* a Delaware corporation, at the time of the operative acts giving rise to liability. Moreover, the petitioner has consistently asserted (and presented evidence at trial) that Firestone breached its fiduciary duty to Bagdon by changing the corporation's state of incorporation *after* it had committed most of the tortious acts at issue and without telling petitioner that the change would limit his rights and remedies as a minority shareholder.

At the very least, the Seventh Circuit could not rule on appeal that the parties' corporation was incorporated in Delaware for purposes of Illinois' choice of law rules absent a highly fact-intensive determination by the District Court as to whether Firestone fraudulently manipulated the state of incorporation of the parties' corporation. However, the District Court

never decided this issue.[5] Thus, the Seventh Circuit flagrantly abused its appellate jurisdiction in making its choice-of-law determination in this case.

IV. The Seventh Circuit Violated the *Erie* Doctrine By Failing to Follow the State Law Which It Held Governed Petitioner's Claims.

Not only did the Seventh Circuit erroneously rule that Delaware law governed here, it failed to follow it after making the ruling. Even the authorities cited by the Seventh Circuit recognized the "black letter law" in Delaware (and elsewhere) that where, as here, a shareholder asserts a claim which is both individual and derivative in nature, the shareholder may proceed individually, even if the primary injury is to the corporation. *Elster v. American Airlines, Inc.*, 34 Del. Ch. 94, 98-99, 100 A.2d 219, 222 (1953); R. Balotti and J. Finkelstein, *The Delaware Law of Corporations and Business Organizations*, §13.6, p. 626 (1989 Suppl.). Here, the Seventh Circuit acknowledged that Bagdon's claims were at least partly individual: "(e)ven Count I involves some injury external to the store-corporation" and "(h)ad Bagdon argued only that Firestone defrauded him personally, he would have been free to proceed." (916 F.2d at 381, Appendix, p. 5a). Thus, by the Court of Appeals' own incorrect analysis, Bagdon's claims were sufficiently individual in nature to entitle him to proceed individually under Delaware law.

Nonetheless, the Seventh Circuit found that Bagdon's fiduciary duty and fraud claims were "derivative" because "Bagdon insisted on recovering profits the corporation lost."[6] (916

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[5] The District instead applied Ohio law based on the choice-of-law clause in the parties' shareholders agreement. (Appendix, pp. 22a-26a). The Seventh Circuit also incorrectly stated that "Bagdon has waived any claim to the benefit of Ohio law by not briefing the choice-of-law question issue in either the district court of this court.," (916 F. 2d at 383, Appendix, p. 8a). In fact, Bagdon discussed the choice-of-law question extensively in his response to Firestone's motion for summary judgment and his opening brief in the Seventh Circuit. (The relevant pages are attached in the Appendix, pp. 38a-47a).

[6] The Seventh Circuit failed to recognize that Bagdon was not seeking recovery of the corporation's lost profits — he was merely asserting that the damages flowing from his individual injuries could be calculated, in part, by reference to these lost profits.

F.2d at 382, Appendix, p. 5a) However, the Seventh Circuit's myopic focus on whether Bagdon's "injury" was "mediated" through the corporation overlooked the fact that injury or economic loss is *not* even a condition precedent for relief for breach of fiduciary duties. *See Lynch v. Vickers Energy Corp.*, 429 A.2d (Del. Supr. 1981); 12B Fletcher, *Cyc. Corp.* at §5816. Even if Bagdon had been seeking to recover lost profits (which he was not), whether or not the "injury" was "mediated" through the corporation would not determine whether his claims were individual or derivative in Delaware or anywhere else.[7] 12B Fletcher, *Cyc. Corp.* at §5912; *Rabkin, v. Philip A. Hunt Chemical Corp.*, 547 A.2d 963 (Del. Ch. 1986); *Abelow v. Symonds*, 38 Del. Ch. 572, 156 A.2d 416 (1959). In *Rabkin* and *Abelow*, the minority shareholders sought what, under the Seventh Circuit's analysis, were derivative-type damages "mediated" through the corporation (i.e., the injuries were measured by lost dividends or a diminution in stock value), but the Delaware courts held that their claims were individual in nature. 547 A. 2d at 969; 156 A. 2d at 419. *Rabkin* and *Abelow* are but examples of the rule that the distinction between individual and derivative actions is *not* to be drawn on the basis of the nature of the relief sought or on whether the injury is "mediated" through the corporation, as the Seventh Circuit held here. Indeed, in *Crane v. Harsco Corp.*, 511 F. Supp. 294 (D. Del. 1981), the District Court in Delaware specifically held that

> "though the line of distinction between injuries giving rise to derivative as opposed to individual actions is 'often a narrow one.' Delaware courts have not drawn it on the basis of the relief sought."

Id. at 304, (citations omitted); 12B Fletcher, *Cyc. Corp.* at §5912. Thus, the Seventh Circuit did not follow Delaware law, as it was required to do in this diversity action, in determining the

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[7] The fact that Seventh Circuit erroneously focused on the measure of damages rather than on the nature of the wrong is highlighted by the fact that had Bagdon used some other measure of damages, such as disgorgement of Firestone's profits (which is not appropriate here because the competing store was unprofitable due to poor management), it would not have changed the nature of the duties Firestone owed to Bagdon or the injuries suffered by Bagdon as a result of Firestone's breach thereof — injuries which were simply not shared by Firestone.

nature of Bagdon's claims. *Taylor v. Aetna Casualty & Surety Co.*, 867 F.2d 705, 706 (1st Cir. 1989). It improperly created its own test of "derivativeness" out of whole cloth.

Contrary to the Seventh Circuit opinion, Delaware law does *not* hold that "a claim is derivative if injury is mediated through the corporation." 916 F. 2d at 383. To the contrary, *Elster*, the case cited by the Seventh Circuit for this proposition, specifically held that the nature of the wrong controls. 34 Del. Ch. 94, 101, 100 A. 2d 219, 223. Moreover, the Delaware Supreme Court has repeatedly held that the proper test for determining if a minority shareholder may sue individually is whether, as here, the action is based on a right belonging to him individually and the injury he suffers is not shared by the other shareholders. *Kramer v. Western Pacific Industries, Inc.*, 546 A. 2d 348 (Del. 1988); *Lipton v. News International, PLC*, 514 A. 2d 1075, 1078 (Del. 1986); *Rabkin*, 547 A.2d at 968-69; 12B Fletcher, *Cyc. Corp.* at §5911. Had the Seventh Circuit applied the proper test, it would have found that Bagdon's action was based on a right belonging to him individually and involved an injury not shared by the other shareholder, thereby mandating a finding that his claims were sufficiently individual in nature to allow him to proceed without joining the parties' corporation.

The Seventh Circuit held (without citing any authority) that any duty not to compete was owed by Firestone to the corporation only and not to Bagdon. (916 F.2d at 384, Appendix, p. 4a) That is patently erroneous.[8] Delaware – like virtually every other state – has explicitly recognized that a majority shareholder in a close corporation owes heightened fiduciary duties of loyalty and fairness *directly* to the minority shareholder, not derivatively through the corporation as stated by the Seventh Circuit. *See e.g., David J. Green & Co. v. Dunhill International, Inc.*, 249

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[8] Firestone *never even disputed* that it owed Bagdon fiduciary duties not to compete against the corporation it operated with him. Firestone did not raise this as a contested issue of fact or law in the pretrial memorandum submitted to the District Court or submit any jury instructions denying that it owed Bagdon such duties. (Copies of Firestone's list of contested issues of fact and law and proposed jury instructions are attached in the Appendix, pp. 32a-37a) In its zeal to give petitioner the "bum's rush" out of federal court, the Court of Appeals completely overlooked Firestone's waiver of this isssue.

A.2d 427 (Del. Ch. 1968); *Orchard v. Covelli*, 590 F. Supp. 1548, 1556-57 (W.D. Pa. 1984) (applying Delaware law). Indeed, this Court recognized a majority shareholder's fiduciary obligation boils down to a duty not to further its own interests at the expense of the minority shareholder. *United States v. Byrum*, 408 U.S. 125, 137-38 n. 11 (1972). Thus, it is no surprise that many courts have held that the majority shareholder's fiduciary duties to a minority shareholder *include* a duty not to compete, and that the breach of this duty gives rise to individual claims. *See e.g., Orchard*, 490 F. Supp. at 1556-57; *Hagshenas v. Gaylord*, 199 Ill. App. 3d 60, 71 (2d Dist. 1990); *Steelman v. Mallory*, 110 Idaho 510, 716 P. 2d 1282 (1986).

In *Orchard*, decided under Delaware law, the court held that a majority shareholder breached fiduciary duties owed to the minority shareholder by, among other things, setting up competing restaurants near the restaurants owned by the parties' corporations. 590 F. Supp. at 1558-59. There can be no doubt that Firestone likewise owed Bagdon a duty to refrain from furthering its own interests by competing with their joint enterprise at Bagdon's expense, the breach of which likewise gave rise to an individual action, even under Delaware law.[9]

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[9] The same is true of Bagdon's fraud claims. Only by distorting the nature of a derivative action could the Seventh Circuit convert a claim based upon a majority shareholder's misrepresentations to a minority shareholder into an action to redress a wrong to the corporation. Fraud claims of the type involved here have always been held to create an individual action because the corporation and the plaintiff's status as a shareholder are irrelevant to such claims. *See e.g., Grogan v. Garner*, 806 F. 2d 829, 834-35 (8th Cir. 1986); *Yanow*, 178 Conn. at 282 n. 9, 422 A.2d at 321 n. 9; *Traylor v. Marine Corp.*, 328 F. Supp. 382, 384 (E.D.Wis. 1971). The monies which Firestone denied Bagdon as a result of its misrepresentation were surely recoverable. Courts have traditionally held that a defrauded party entitled to be placed in same position it would have been in had the misrepresentation been true. *Brown v. Broadway Perryville Lumber Co.*, 156 Ill. App. 3d 16 (2d Dist. 1987). That a directed verdict on petitioner's fraud claims was entered at the close of all the evidence (a decision which has *not* been reviewed) does not render these claims (which even Firestone admitted were individual) a nullity for the purpose of determining the individual or derivative nature of Bagdon's claims, as the Seventh Circuit suggests. Rather, the fraud claims are strong evidence why the case could properly proceed in the absence of the parties' corporation.

The individual nature of Bagdon's claim is confirmed by the fact that his injury was not shared by Firestone, the only other shareholder. In *Rabkin*, the Delaware court held that the minority stockholders' injuries (lowered stock prices) during the merger of the parties' corporation were not shared by the majority shareholder, even though all the shareholders received the same price for their stock, because the majority shareholder acquired the company and thereby received a benefit denied to the minority shareholders. 547 A.2d at 969. *Accord*, *First Hawaiian Bank v. Alexander*, 558 F. Supp. 1128, 1133 (D. Haw. 1983); *Traylor*, 328 F. Supp. at 384. As the majority stockholder in *Rabkin*, Firestone was not injured by its opening of a competing Firestone store 700 yards away from the store operated by the parties' corporation, because whatever money Firestone lost at the parties' store, it made up at its competing facility. Looking at the overall gain to Firestone from its wrongdoing, as required by *Rabkin*, it is clear that only Bagdon was injured here.

Thus, by focusing its inquiry on the measure of damages, rather than the nature of the wrong and the injury complained of, the Seventh Circuit did *not* follow Delaware law in this diversity action as it was required to do under the *Erie* doctrine. Instead, it improperly "blaze(d) a new trail where the footprints of the state court point conspicuously in a contrary direction." *Taylor v. Aetna Casualty & Surety Co.*, 867 F. 2d 705, 706 (1st Cir. 1989).

CONCLUSION

For each and all of the foregoing reasons, petitioner respectfully submits that the Seventh Circuit's fundamental error in dismissing his action under Rule 19 of the Federal Rules of Civil Procedure warrants a Writ of Certiorari.

Respectfully submitted,

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APPENDIX

In the
United States Court of Appeals
For the Seventh Circuit

Nos. 89-3724 & 89-3774

EDWARD F. BAGDON,

Plaintiff-Appellee—Cross-Appellant,

v.

BRIDGESTONE/FIRESTONE, INC.,

Defendant-Appellant—Cross-Appellee.

Appeals from the United States District Court
for the Northern District of Illinois, Eastern Division.
No. 87 C 4698—**William T. Hart**, *Judge.*

ARGUED SEPTEMBER 12, 1990—DECIDED OCTOBER 17, 1990

Before WOOD, JR., and EASTERBROOK, *Circuit Judges*, and GRANT, *Senior District Judge.**

EASTERBROOK, *Circuit Judge.* Many of the Firestone auto service stores throughout the nation have been separately incorporated. Firestone establishes corporations in which it and the store's manager own stock, using this as a device to reward the manager for success and cement the manager's loyalty to the firm. Although this may spur managers to success, it has other effects. With the corporate form come the duties of corporate law. Firestone

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* Hon. Robert A. Grant, of the Northern District of Indiana, sitting by designation.

acquired 300 auto centers from J.C. Penney Co. and operated some in competition with its existing stores. Edward F. Bagdon, the manager of a store in which he owned stock, filed this suit, contending that by reopening the Penney's store under the Firestone name, Firestone violated its duty to him and to his store-corporation. The jury agreed and awarded Bagdon $912,636, which the district judge reduced to $306,995. 1989 U.S. Dist. LEXIS 13968 (N.D. Ill.). Having won by invoking the rules of corporate law, Bagdon now must persuade us that this is not "really" a corporate case—for, if it is, the store-corporation is a necessary party, and the suit must be dismissed for lack of complete diversity of citizenship.

Firestone (Bridgestone/Firestone, Inc., after its acquisition by Bridgestone Corp.; we call it "Firestone" for simplicity) had some 1,200 company-owned tire and auto service stores throughout the country in 1983. Bagdon has been with Firestone since 1962; since 1970 he has managed a store in the Ford City Shopping Center on the west side of Chicago. In 1971 Bagdon and Firestone incorporated this store so that Bagdon could share in its profits. In 1983 the store (Firestone Stores of Chicago-Ford, Inc.), originally an Illinois corporation, was reincorporated in Delaware with Bagdon's consent. Bagdon owns 49% of the stock, for which he paid about $83,500. Firestone owns the other 51%.

Ford City is a big mall, with four anchor stores, including J.C. Penney, when it opened in 1965. Penney operated a large auto supply and service center adjoining its store. Penney's auto center was 700 yards east of Bagdon's Firestone store. In 1981 Penney's auto center at Ford City did $1.714 million in business; Bagdon's Firestone store had gross sales about half that level. In 1982 Penney started to pare down its auto business, closing some of its stores on the west coast. Firestone opened negotiations to buy what it could. Penney was willing to sell—but only en bloc. In early 1983 Firestone bought or leased all of Penney's auto service centers. Some were

located hard by existing Firestone outlets. Ford City was one of the conflicts. Firestone held an internal debate and eventually decided that Ford City could support two Firestone stores. The former Penney center opened under the Firestone trademark on June 1, 1983. We call this "Ford City East", to distinguish it from Bagdon's "Ford City West".

Firestone has not been able to match Penney's level of sales at Ford City East. In 1984, its first full year as a Firestone store, Ford City East grossed $849,000. (We round all figures to the nearest thousand dollars.) By 1988 its sales were down to $707,000. Bagdon's store also experienced declining sales through the period. From gross sales of $824,000 in 1982, the last full year of Penney's operation of Ford City East, sales at Bagdon's store rose to $914,000 in 1984 and then slumped to $736,000 by 1988. Ford City West remained profitable, however. Bagdon's share of the store's profits was $28,000 in 1982 and $26,000 in 1988, with a high of $38,000 and a low of $14,000 in between. Bagdon also received salary and bonus from Firestone (he is employed by Firestone as well as by the store-corporation); this compensation increased from $39,000 in 1982 to $53,000 in 1988.

Bagdon filed this suit in 1987, invoking the diversity jurisdiction of 28 U.S.C. §1332(a). He is a citizen of Illinois; in 1987 Firestone was incorporated in Ohio and has its principal place of business there. Bagdon contends that had Firestone sold the former Penney store to a third party rather than operating it as an auto center, Ford City West would have picked up a substantial fraction of Penney's sales, greatly increasing Ford City West's profits—and his 49% share of them, not to mention his bonus from Firestone. Firestone moved to dismiss, contending that the store-corporation is an indispensable party because Bagdon's loss derives from injury to the corporation. Ford City West is incorporated in Delaware and has its principal place of business in Illinois. *Smith v. Sperling*, 354 U.S. 91 (1957), requires the corporation to be aligned

as a defendant in shareholders' derivative litigation if it opposes the suit (as the store-corporation does). Its presence as a defendant would destroy the complete diversity of citizenship that since *Strawbridge v. Curtiss*, 7 U.S. (3 Cranch) 267 (1806), has been essential to jurisdiction under §1332. The district judge denied this motion. 1987 U.S. Dist. LEXIS 9395 (N.D. Ill.). Explaining why requires a quick tour through Bagdon's complaint.

Count I of Bagdon's complaint alleges that by establishing Ford City East in competition with Ford City West, Firestone violated the duty a controlling shareholder owes to the corporation, and derivatively to the minority investors. Diverting business from Ford City West to Ford City East reduced the store's sales, and thus its profits. This looks like a standard derivative suit, for any injury to Bagdon is mediated through the corporation: Bagdon does not lose unless Ford City West loses. *Kagan v. Edison Brothers Stores, Inc.*, 907 F.2d 690 (7th Cir. 1990); *Mid-State Fertilizer Co. v. Exchange National Bank*, 877 F.2d 1333, 1335-36 (7th Cir. 1989). Firestone's duty as a majority shareholder ran to the corporation, not directly to the minority investor. As the American Law Institute puts it, summarizing the theme of the cases, "An action in which the holder can prevail only by showing an injury or breach of duty to the corporation should be treated as a derivative action." *Principles of Corporate Governance: Analysis and Recommendations* §7.01(a) (Tent. Draft No. 8, 1988). See also Deborah A. DeMott, *Shareholder Derivative Actions: Law and Practice* §2.01 (1987). The bulk of the jury's award in Bagdon's favor represented profits Ford City West lost because of competition from Ford City East.

Other counts in the complaint did not depend on injury to Ford City West. Count II alleges that Firestone defrauded Bagdon personally, telling him that he would be appointed to manage Ford City East or that Ford City East would be added to his store-corporation. Assurances of this kind led him to remain with Firestone, to his detri-

ment, although he would have left had he known the truth. Count III states a claim under the Illinois Consumer Fraud and Deceptive Business Practices Act, Ill. Rev. Stat. ch. 121½ ¶262, on the theory that Ford City East engendered confusion in consumers' minds. In denying Firestone's motion to dismiss the case, the district judge observed that Counts II and III are claims personal to Bagdon, which he is entitled to pursue without involving the store-corporation. Even Count I involves some injury external to the store-corporation: Bagdon seeks to recover the diminution in the value of his bonuses, paid directly by Firestone. The district judge concluded that this suit therefore may proceed without the store-corporation, a jurisdictional spoiler.

Bagdon had claims that he could pursue without adding the corporation. Often a single series of events gives rise to both direct and derivative litigation. E.g., *Twohy v. First National Bank of Chicago*, 758 F.2d 1185, 1191-92 (7th Cir. 1985); *Buschmann v. Professional Men's Ass'n*, 405 F.2d 659, 663 (7th Cir. 1969). The plaintiff as master of the complaint may choose which claims to present. Had Bagdon argued only that Firestone defrauded him personally, he would have been free to proceed. Cf. *Spartech Corp. v. Opper*, 890 F.2d 949, 952-54 (7th Cir. 1989). His claims were not so limited but included a demand for damages on account of the reduction in corporate profits. As things turned out, the district judge granted summary judgment to Firestone on Counts II and III—Count II because the facts did not support relief, and Count III because goods that are accurately labeled (Ford City East is a real Firestone store) do not violate the statute.

Bagdon insisted on recovering profits the corporation lost. If that claim is derivative, then the corporation had to be joined. The district judge doubted this proposition, observing: "Rule 19 is to be applied pragmatically, with a focus on a realistic analysis of the facts of each case." The court noted that adding the store-corporation would defeat jurisdiction, which it was reluctant to do—especially

when both of the shareholders were parties. We are inclined to look through the other end of this telescope. The question is not whether it is just to add a party that knocks a case out of federal court, but whether the court should strain to keep it in. The principal justification for the diversity jurisdiction, the potential for bias against out-of-state parties, cannot explain why Bagdon, a citizen of Illinois, wants to litigate in federal court against an out-of-state defendant. When the out-of-state party is content with the state's system of justice, the claim on the resources of the federal court is weakest. In the end, however, neither the district court's views nor ours matter much. Rule 19 is *not* "applied pragmatically" in derivative cases. If this is a derivative suit, the corporation is an indispensable party. So much has been settled since *Davenport v. Dows*, 85 U.S. (18 Wall.) 626 (1873), a decision reaffirmed after the adoption of Rule 19. *Koster v. (American) Lumbermens Mutual Casualty Co.*, 330 U.S. 518, 522-23 n. 2 (1947).

Smith v. Sperling adopts a mechanical rule: the unwilling corporation is aligned as a defendant. Sometimes this creates diversity (as in *Sperling*), sometimes it defeats diversity. *Sperling* is not a one way street, with the corporation participating only when its presence creates federal jurisdiction. If Count I of Bagdon's complaint states a derivative claim, then the complaint must be dismissed. Bagdon could in principle dismiss the claim that spoils jurisdiction, could have done so even in this court, *Newman-Green, Inc. v. Alfonzo-Larrain*, 109 S. Ct. 2218 (1989). Despite the drumbeat of jurisdictional objections from Firestone, Bagdon did not offer to drop all claim to damages on account of profits the corporation lost.

Thus we arrive at the question whether a claim that the majority stockholder wrongly competed with the corporation is derivative. Bagdon and Firestone agree that this is a question of state law—for the identity of the real party in interest depends on the law creating the claim. See also *Burks v. Lasker*, 441 U.S. 471 (1979), and *Star-*

rels v. First National Bank of Chicago, 870 F.2d 1168 (7th Cir. 1989), the former implying, and the latter holding, that when state law supplies the rule of decision in a derivative suit, it also governs procedures such as the requirement of demand on directors. Cf. *Kamen v. Kemper Financial Services, Inc.*, 908 F.2d 1338, 1341-42 (7th Cir. 1990) (federal law governs procedure when it supplies the rule of decision).

Which state's law? We turn to the choice-of-law principles of the forum state, Illinois in this case. *Klaxon Co. v. Stentor Electric Manufacturing Co.*, 313 U.S. 487 (1941). Illinois, like other states, uses as its choice-of-law principle in corporate governance the internal affairs doctrine. *Paulman v. Kritzer*, 38 Ill. 2d 101, 230 N.E.2d 262 (1967), affirming 74 Ill. App. 2d 284, 219 N.E.2d 541 (2d Dist. 1966); *Pros v. Mid-America Computer Corp.*, 142 Ill. App. 3d 453, 491 N.E.2d 851, 856-57 (2d Dist. 1986); *Kern v. Chicago & Eastern R.R.*, 6 Ill. App. 3d 347, 285 N.E.2d 501, 503 (1st Dist. 1972). See *Restatement (2d) of Conflicts of Law* §§ 301-10 (1971). This sends us to Delaware, where Ford City West is incorporated. The choice between derivative and direct litigation is a choice about how (and by whom) the internal affairs of the firm are managed. If the suit is derivative, the board may have an opportunity to control or dismiss the litigation. *Spiegel v. Buntrock*, 571 A.2d 767 (Del. 1990). Recoveries pass through the corporate treasury, a process that both protects creditors (who get first dibs) and avoids questions of apportionment that crop up when a jury must determine how much the firm would have paid out in dividends. *Mid-State*, 877 F.2d at 1335-36. See DeMott at §2.01, listing other ways in which the choice matters to the corporation's operations.

The only candidate other than Delaware is Ohio, whose law Bagdon and Firestone elected in a 1981 agreement governing Bagdon's role in the store-corporation. When denying Firestone's motion to dismiss, the district court observed that "[n]either plaintiff nor defendant [has] dis-

cussed which state's law is applicable to this case", an observation it reiterated when granting Firestone's motion two years later to dismiss Counts II and III. 1989 U.S. Dist. LEXIS 2607. On appeal the silence continues. Firestone contends that Bagdon's claim is derivative, scarcely mentioning either state law or this clause; Bagdon does not deign to discuss the subject. Indeed, Bagdon's brief devotes only one paragraph to the question whether the claim is derivative, citing nary a case and not suggesting that choice of law makes a difference. (A second paragraph cites two cases for the proposition that fiduciaries are liable for the foreseeable consequences of their wrongful actions, neither here nor there when the question is whether the claim for a diminution in corporate profits, and derivatively Bagdon's dividends, belongs to the corporation rather than the shareholder.)

The difference between Ohio and Delaware law is substantial. *Crosby v. Beam*, 47 Ohio St. 3d 105, 548 N.E.2d 217 (1989), allows minority shareholders in close corporations to sue individually when they claim that the controlling shareholders deprived the minority of the benefits of their investment. Delaware takes the opposite view. (We discuss its cases below.) For two reasons, we conclude that Delaware law governs. First, Bagdon has waived any claim to the benefit of Ohio law by not briefing the choice-of-law question issue in either the district court or this court. The internal affairs doctrine points to Delaware; something other than silence is necessary to persuade us to go elsewhere. Second, if the question were before us we would incline to think that the choice-of-law clause governs the validity and effect of the contract and does not affect corporate law on subjects outside that pact. Delaware supplies an elaborate body of law to govern corporate affairs, law that applies unless varied by contract. The agreement between Bagdon and Firestone settles many subjects concerning Bagdon's employment (it contains a no-competition clause, for example) and their relative stakes as investors (it says among many other

things that Firestone's holdings shall not be less that 51% and that Bagdon shall have preemptive rights if the firm issues additional stock). It does not speak to corporate governance—questions such as how directors are elected, whether demand on directors is necessary before pursuing claims, and the like. Investors may strike agreements between themselves on many subjects, under many bodies of law, without altering the principle that the law of the state of incorporation regulates internal affairs.

Delaware law it is, then. Delaware follows the venerable rule that a claim is derivative if injury is mediated through the corporation. *Elster v. American Airlines, Inc.*, 34 Del. Ch. 94, 100 A.2d 219 (1953). It also follows the "special injury" exception to this rule, *id.* at 222, allowing a shareholder to litigate independently if the wrong to the corporation inflicts a distinct and disproportionate injury on the investor. The "special injury" rule allows Bagdon to pursue his claim that Firestone defrauded him by promising him suzerainty over Ford City East. Bagdon's claim for lost bonus comes within the same shelter. Although the bonus varies with Ford City West's profits, the injury to Bagdon is nonetheless "special" because Firestone pays Bagdon directly.

Ohio, like a few other states, has expanded the "special injury" doctrine into a general exception for closely held corporations, treating them as if they were partnerships. *Crosby* follows *Donahue v. Rodd Electrotype Co.*, 367 Mass. 578, 328 N.E.2d 505 (1975), and *Jones v. H.F. Ahmanson & Co.*, 1 Cal. 3d 93, 460 P.2d 464, 81 Cal. Rptr. 592 (1969). The American Law Institute recommends that other states do the same. *Principles of Corporate Governance* §7.01(d) and pp. 22-25 (comment), 30-36 (reporter's note). The premise of this extension may be questioned. Corporations are *not* partnerships. Whether to incorporate entails a choice of many formalities. Commercial rules should be predictable; this objective is best served by treating corporations as what they are, allowing the investors and other participants to vary the rules

by contract if they think deviations warranted. So it is understandable that not all states have joined the parade.

Delaware, for one, has not. When the controlling stockholder of a family corporation transferred its assets for inadequate consideration, Delaware required the minority investors to pursue derivative litigation, observing that the value of the minority shares went down only to the extent the corporation as an entity was worth less. *Taormina v. Taormina Corp.*, 32 Del. Ch. 18, 78 A.2d 473 (1951). When the owner of 95% of a closely held firm's stock proposed to liquidate the corporation at what the minority thought was an inadequate price, Delaware again required the minority to bring the objection derivatively. *Abelow v. Symonds*, 38 Del. Ch. 572, 156 A.2d 416 (1959). In neither case did the Chancellor think it important that the wrong alleged involved the controlling stockholder enriching itself at corporate expense, or that the corporation was closely held. The author of the leading treatise treats *Abelow* as establishing the proposition that "the closely held nature of the corporation [is] irrelevant to the distinction between direct and derivative actions." DeMott, §2.01 at 4. The Reporter of the ALI's corporate governance project disapproves, *Principles of Corporate Governance* at 36, but *Abelow* is the law of Delaware today. The Supreme Court of Delaware often cites *Abelow* and *Taormina* favorably, e.g., *Kramer v. Western Pacific Industries, Inc.*, 546 A.2d 348, 351-52 (Del. 1988); *Zapata Corp. v. Maldonado*, 430 A.2d 779, 784 (Del. 1981), and it has rejected the more elastic approaches of other jurisdictions, *Bokat v. Getty Oil Co.*, 262 A.2d 246 (Del. 1970).

Jurisdictional rules should be simple. Why spend years litigating the right court in which to litigate? Certainty is elusive in a case such as this, in which jurisdiction depends on a question of characterization that different states would resolve differently. Lest the details of the "special injury" doctrine, and its implementation in Delaware, obscure the fundamentals, we repeat the theme. Bagdon believes that Firestone wrongly competed with

Ford City West. Firestone owed that duty to the store-corporation, not to its employee Bagdon—an employee Firestone was free to dismiss for any or no reason. Violation of the duty injured the store-corporation, and Bagdon's loss was derivative (he could not receive dividends out of profits the corporation did not make). Bagdon alleged some direct injuries, which he was free to litigate, but he could not recover on account of the store-corporation's diminished profits without making the corporation a party. The district court therefore should have granted Firestone's motion to dismiss this case for want of diversity jurisdiction. We vacate the judgment and remand for that purpose.

VACATED

A true Copy:

Teste:

Clerk of the United States Court of Appeals for the Seventh Circuit

USCA 79004—Midwest Law Printing Co., Inc., Chicago—10-17-90—500

United States Court of Appeals

For the Seventh Circuit
Chicago, Illinois 60604

JUDGMENT — WITH ORAL ARGUMENT

Date: October 17, 1990

BEFORE: **Honorable** Harlington Wood, Jr., Circuit Judge
Honorable Frank H. Easterbrook, Circuit Judge
Honorable Robert A. Grant, Senior District Judge*

Nos. 89-3724 and 89-3774

EDWARD F. BAGDON,
Plaintiff-Appellee
Cross-Appellant

v.

FIRESTONE TIRE AND RUBBER COMPANY, an Ohio corporation,
Defendant-Appellant
Cross-Appellee

Appeals from the United States District Court for the Northern District of Illinois, Eastern Division

No. 87 C 4698,

Judge **William T. Hart**

These causes were heard on the record from the above mentioned district court, and were argued by counsel.

On consideration whereof, **IT IS ORDERED AND ADJUDGED** by this Court that the judgment of the District Court in these causes appealed from be, and the same are hereby, VACATED, and REMANDED, in accordance with the opinion of this Court filed this date. Bridgestone shall recover its cost.

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* Honorable Robert A. Grant, of the Northern District of Indiana, sitting by designation.

United States Court of Appeals

For the Seventh Circuit
Chicago, Illinois 60604

November 13, 1990

Before

Hon Harlington Wood, Jr., Circuit Judge
Hon Frank H. Easterbrook, Circuit Judge
Hon Robert A. Grant, Senior District Judge*

EDWARD F. BAGDON,
Plaintiff-Appellee
Cross-Appellant,

Nos. 89-3724 &
89-3774 *vs.*

BRIDGESTONE/FIRESTONE, INC.,
Defendant-Appellant
Cross-Appellee.

Appeals from the United States District Court for the Northern District of Illinois, Eastern Division

No. 87 C 4698

William T. Hart

Order

Plaintiff-Appellee filed a petition for rehearing and suggestion of rehearing en banc on October 31, 1990. No judge in regular active service has requested a vote on the suggestion of rehearing en banc, and all of the judges on the panel have voted to deny rehearing. The petition for rehearing is therefore Denied.

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* Hon. Robert A. Grant, of the Northern District of Indiana, sitting by designation.

In The
United States District Court
For the Northern District of Illinois
Eastern Division

EDWARD F. BAGDON,
Plaintiff,

v.

FIRESTONE TIRE & RUBBER COMPANY, an Ohio corporation,
Defendant.

No. 87 C 4698

MEMORANDUM OPINION AND ORDER

Plaintiff Edward Bagdon, a resident of Illinois, filed a complaint naming Firestone Tire & Rubber Company, an Ohio corporation, as defendant. Plaintiff alleges that defendant engaged in unfair business practices and misrepresentation, in violation of both common law and the Illinois Consumer Fraud and Deceptive Business Practice Act, Ill. Rev. Stat. (1985), ch. 121 1/2, ¶ 262 *et seq.*

Defendant has moved to dismiss the cause of action under Rules 12(b)(7) and 19 of the Federal Rules of Civil Procedure. Defendant claims plaintiff has failed to join an indispensable party to the action as the claims pleaded in the complaint do not belong to plaintiff, but to a corporation of which plaintiff and defendant are the sole shareholders. For the reasons set forth below, defendant's motion to dismiss is denied.

FACTS

In 1971 plaintiff and defendant entered into an agreement to form an Illinois corporation named Firestone Stores of Chicago-Ford, Inc. ("Firestone I"). This corporation's business operations were at the Ford City Shopping Center in Chicago, Illinois. The

agreement provided that defendant would, at all times, be the majority shareholder of Firestone I. Plaintiff, the sole minority shareholder of Firestone I, was also its president and one of its three directors. The other two directors and the other officers of Firestone I were nominees and employees of the defendant. Although the agreement between plaintiff and defendant was revised in 1981, most of the elements of the agreement significant for the issues before this court remained the same: (1) defendant is the majority shareholder and plaintiff is the minority shareholder; (2) plaintiff is the president and one of three directors of the corporation; and is in charge of the daily operations of the corporation; and (3) the other directors and officers of the corporation are nominees and employees of defendant. The 1981 agreement additionally provided that Ohio law would govern disputes between the parties.

In March 1983, Firestone I, an Illinois corporation, was merged into a Delaware corporation of the same name which will be referred to as "Firestone II." Firestone II operated at the same location and plaintiff continued in his role as president, director, and minority shareholder. The principal place of business of Firestone II is Illinois. Also in 1983, defendant acquired the automobile service facilities previously operated by J.C. Penney Company in Ford City Shopping Center ("Firestone III"). Defendant informed plaintiff that the acquired facility would be operated by Firesone II and requested that plaintiff recruit personnel for the new facility. Just prior to opening the new facility, defendant advised plaintiff that Firestone II would not be allowed to operate the new facility and that the new facility would be operated solely by defendant. Defendant continues to operate Firestone III and directly competes with the store operated by Firestone II. Plaintiff alleges various activities designed to steer customers away from Firestone II and to Firestone III. In his complaint, plaintiff contends that defendant's acts (1) constitute a breach of fiduciary duty owed by a majority shareholder to a minority shareholder, (2) constitute misrepresentations which were made in order to procure plaintiff's assistance and to prevent him from seeking redress, and (3) violate the Illinois Consumer Fraud and Deceptive Business Practices Act. Plaintiff seeks both actual and punitive damages as well as an injunction enjoining defendant from owning and operating

any competitive facilities within a thirty-five mile radius of Firestone II.

Defendant moved to dismiss plaintiff's complaint pursuant to Rules 12(b)(7) and 19 of the Federal Rules of Civil Procedure asserting that Firestone II is an indispensable party to this action and that it would be aligned as a defendant. As the principal place of business of Firestone II is Illinois, defendant contends its joinder would destroy diversity requiring dismissal of the cause of action.

DISCUSSION

Defendant contends that Firestone II is an indispensable party to this action. The Supreme Court has noted that Rule 19 is to be applied pragmatically, with a focus on a realistic analysis of the facts of each case. *See Provident Tradesmens Bank v. Patterson*, 390 U.S. 102, 118-19 (1968); *Schmidt v. E.N. Maisel & Associates,* 105 F.R.D. 157, 159 (N.D. Ill. 1985). In this case, a realistic analysis of the facts reveals that although Firestone II is not a party to this action, its interests are adequately represented as both of its shareholders are parties to this suit. In the brief in support of its motion to dismiss, defendant makes the assertion that unless Firestone II is a party to this action, its absence creates a risk of duplicative litigation and inconsistent obligations. This assertion overlooks the fact that all of the shareholders of Firestone II are parties in this case and therefore the interests of Firestone II are adequately represented. *Cf. Johnson v. Gilbert,* 127 Ariz. 410 621 P.2d 916, 918 (Ariz. App. 1980). Defendant's arguments to the contrary stem largely from its view that the causes of action which plaintiff alleges belong, not to plaintiff himself, but to Firestone II, and that plaintiff can therefore only sue derivatively on behalf of the corporation.

It has long been settled that the same allegations of facts which support a derivative suit may also support an individual cause of action by a corporation's shareholder. *Borak v. J.I. Case Company*, 317 F.2d 838, 845 (7th Cir. 1963), *aff'd*, 377 U.S. 426 (1964); *Buschmann v. Professional Men's Ass'n*, 405 F.2d 659, 663 (7th Cir. 1969). The Seventh Circuit has noted:

> Under general principles of United States corporate law, as well as under Illinois law, a stockholder of a corporation has no personal or individual right of action against third persons for damages that result indirectly to the stockholder because of an injury to the corporation. Certain 'often overlapping' exceptions to the general rule have been recognized such as where a special contractual duty exits between the wrongdoer and shareholder or where the shareholder suffers an injury separate and distinct from that suffered by other shareholders.

Twohy v. First National Bank of Chicago, 758 F.2d 1185, 1194 (7th Cir. 1985).[1] In the present case, plaintiff has suffered injuries separate and distinct from both defendant and the absent corporation. Plaintiff's separate injuries are primarily his bonus incentives lost when business was steered from Firestone II to Firestone III. Also, as long as he is employed by Firestone II he cannot open a competing store in an area within a thirty-five mile radius of Firestone II. The alleged mispresentations of defendant may have prevented plaintiff from deciding to sell out his hsare and instead pursue other opportunities. Also, he devoted time to setting up Firestone III based on alleged misrepresentations. On the other hand, defendant will not be impacted in the same manner as plaintiff, as any business opportunities diverted from Firestone II will be directed to defendant's own store, Firestone III. In addition, plaintiff's allegations regarding misrepresentation are clearly individual claims belonging solely to plaintiff and not to the corporation. Plaintiff's causes of action are personal and not derivative as at least some of his injuries arise not from reduced dividends or a reduced value of his share of Firestone II, but from reduced income as an employee or otherwise. His injuries are not solely from his relationship with Firestone II as a stockholder, but also arise from his relationship with defendant and his employment

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[1] Neither plaintiff nor defendant have discussed which state's law is applicable in this case. Regardless of whether Illinois, Delaware, or Ohio law applies, the rule is the same, a shareholder may sue for his individual injury without the corporation being a party. *See Zokoych v. Spaulding*, 36 Ill. App.3d 654, 344 N.E.2d 805, 813 (1976); *Lipton v. News International*, 514 A.2d 1075, 1078 (Del. 1986); *Adair v. Wozniak*, 23 Ohio St.3d 174, 492 N.E.2d 426, 428 (1986).

relationship with Firestone II. Even if some of the alleged facts could also support a derivative cause of action, plaintiff can proceed individually since he has individual injuries separate from Firstone II. *See Buschmann, supra. See also Graham v. Slaughter,* 624 F. Supp. 222, 223 (N.D. Ill. 1985).

The finding that plaintiff should be allowed to assert his cause of action as an individual, rather than derivatively, is further bolstered by an analysis of the specific factors contained in Rule 19, which governs compulsory joinder. "When the joinder of the absent party would destroy diversity jurisdiction . . . Rule 19(a) is inapplicable." *Pasco International (London) Ltd. v. Stenograph Corp.*, 637 F.2d 496, 500 (7th Cir. 1980). Firestone II would be aligned as a defendant, *see Van Gelder v. Taylor*, 621 F. Supp. 613, 620-21 (N.D. Ill. 1985), and therefore its joinder would destroy diversity jurisdiction requiring an analysis under Rule 19(b). *See Bio-Analytical Services v. Edgewater Hospital, Inc.*, 565 F.2d 450, 452 (7th Cir.), *cert. denied*, 439 U.S. 820 (1977).

Under Rule 19(b) the inquiry is "whether in equity and good conscience the action should proceed among the parties" or whether the absent person is indispensable, mandating dismissal of the action. Four factors must be considered: (1) the prejudicial effect of a judgment rendered in the absence of the party; (2) the extent to which such prejudice may be avoided; (3) the adequacy of the judgment in the party's absence; and (4) the availability of an adequate remedy if the action is dismissed. *Id.* In this case, defendant has not shown that Firestone II is an indispensable party to this action under these four factors.

Under the first two factors, the consideration is whether a judgment rendered in a person's absence might be prejudicial to the absent person and whether that prejudice might be lessened or avoided by shaping the relief. As noted above, Firestone II will not be prejudiced in any way as all of its shareholders, and essentially all of Firestone's II's officers and directors, are already in this case. In addition, defendant is not threatened by multiple litigation in this case unless it chooses to effectively sue itself. The third factor under Rule 19(b), whether a judgment rendered in the person's absence will be adequate, is clearly met here. The Supreme Court reads the third factor as referring to the "public stake in settling disputes by wholes, whenever possible."

Provident Tradesmens Bank, 390 U.S. at 111. The interest in complete resolution of a controversy by wholes is met in this case as no other party will seek redress against defendant when the present controversy between plaintiff and defendant is resolved. The fourth factor, whether plaintiff will have an adequate remedy if the action is dismissed for nonjoinder, wheile present in this case, is not dispositive. While the availablity of the alternative Illinois forum renders a Rule 19(b) dismissal less onerous, the availablity of an alternative remedy, standing alone, is not a sufficient reason for deciding that the action should not proceed. *Bio-Analytical Services,* 565 F.2d at 453.

Defendant's contentions that plaintiff's action belongs to Firestone II, that plaintiff should proceed derivatively and that, therefore, Firestone II is an indispensable party to this action are without merit. Therefore, defendant's motion is denied.

IT IS THEREFORE ORDERED that defendant's motion to dismiss for failure to join an indispensable party is denied. Defendant is ordered to answer the complaint within 14 days.

ENTER:

/s/ WILLIAM J. HART

UNITED STATES DISTRICT JUDGE

Dated: October 8, 1987

In The
United States District Court
For the Northern District of Illinois
Eastern Division

EDWARD BAGDON,
Plaintiff,

v.

THE FIRESTONE TIRE & RUBBER COMPANY, an Ohio corporation,
Defendant.

No. 87 C 4698

MEMORANDUM OPINION AND ORDER

Plaintiff Edward Bagdon brought this action against defendant Firestone Tire & Rubber Company ("Firestone"), alleging breach of fiduciary duty, fraud, and violation of the Illinois Consumer Fraud and Deceptive Business Practices Act, Ill. Rev. Stat. ch. 121 1/2, ¶ 261 *et seq.* Before the court is defendant's motion for partial summary judgment. For the reasons outlined below, the motion is denied.

FACTS

Bagdon began working for Firestone in 1961. Since mid-1970, he has managed the Firestone automotive store at 7615 S. Cicero Avenue, in Chicago, Illinois. His store is located on the west side of the Ford City shopping center. In March, 1971, the parties organized an Illinois corporation, Firestone Stores of Chicago-Ford, Inc., to operate this store. Bagdon continued as the store manager. The parties describe the entity as an "M & M" corporation, with Firestone the majority shareholder and Bagdon the minority shareholder. The parties were the only shareholders. Ten years later, the parties substituted the 1971 agreement with a new M & M contract. Under the terms of the 1981 agreement,

Bagdon held roughly 49% of the common stock and Firestone held the remainder. Sometime in 1983 (the parties disagree on the exact date), Firestone Stores of Chicago-Ford, Inc. merged into a newly formed Delaware corporation, Firestone Stores Delaware. Bagdon was, and still is, the manager and sole minority shareholder of the new corporation and Firestone is still the majority shareholder. According to Bagdon, this merger of the Illinois corporation into a Delaware corporation was only a change in the corporate name and state of incorporation. It did not, he claims, purport to alter the terms of the 1981 M & M agreement.

Meanwhile, in early 1983, Firestone acquired approximately 300 J.C. Penney automotive stores nationwide. Under the terms of the purchase agreement, Firestone was obligated to buy all of these stores. According to Bagdon, however, Firestone was not obligated to convert every J.C. Penney store into a Firestone automotive store. That is, Bagdon claims Firestone in some instances opted to lease the J.C. Penney store to non-automotive businesses, rather than convert it to a Firestone outlet.

One J.C. Penney store converted to a Firestone outlet was the store on the east side of the Ford city shopping center. This new store is not far from Bagdon's store. According to Bagdon, Firestone decided to open this new store as a Firestone outlet notwithstanding its own feasibility studies that the new store would conflict with Bagdon's store. When Bagdon expressed his concern to Firestone supervisory personnel about the potential effect of the competing store, they repeatedly told him not to worry "because Firestone will take care of you." According to Bagdon, several Firestone officials expressly promised that he would manage both stores. With these assurances in mind, Bagdon agreed to Firestone's request that he help establish the new store. Bagdon, who had never before been asked to help set up a competing store, recruited new employees, inspected the equipment in the new facility, and discussed taking the inventory for the new store.

Just before the new facility opened in June, 1983, Firestone told Bagdon for the first time that he would not manage the new store. After the store opened, Bagdon complained on a number of occasions about its competition with his store. He

says Firstone repeatedly told him to be patient and that the new store would be his in the future. Once, as late as April, 1985, Bagdon was told he would get the new store if he somehow dissolved the union at his store. (The new store was a non-union shop.) On other occasions, the new store was promised him without this condition.

Bagdon has not been given the new store. He has no share in the new facility. He filed this three count complaint May 22, 1987. In the first count, he alleges Firestone breached its duty as majority shareholder. He seeks compensatory and punitive damages. Firestone has moved for summary judgment only as to the request for punitive damages. In his second count, Bagdon alleges Firestone engaged in a scheme to defraud. He claims Firestone's repeated promises that he would get the new store induced him to refrain from competing with it. The last count is a claim under the Illinois Consumer Fraud and Deceptive Business Practices Act, Ill. Rev. Stat. ch. 121 1/2, ¶ 261 *et seq.* Bagdon says Firestone's actions in operating and promoting the new store caused widespread consumer confusion. Firestone has moved for complete summary judgment on Counts II and III.

DISCUSSION

I. Count I: Breach of Fiduciary Duty

Firestone has moved for partial summary judgment on the breach of fiduciary duty claim, arguing that Bagdon cannot recover punitive damages. According to Firestone, under Delaware law minority stockholders cannot recover punitive damages for breach of fiduciary duty by the majority.

Firestone's argument in favor of Delaware law is as follows: the court must apply Illinois choice-of-law principles, *Klaxon Co. v. Stentor Electric Mfg. Co.*, 313 U.S. 487, 496 (1941); *Secon Service System v. St. Joseph Bank & Trust*, 855 F.2d 406, 412 (7th Cir. 1988), and in Illinois, the law of the state of incorporation governs the fiduciary obligations of majority shareholders. *See Paulman v. Kritzer*, 74 Ill. App. 2d 284, 219 N.E.2d 541 (2d Dist. 1966);

see also Restatement (Second) Conflict of Laws § 306 (1971; 1986 Suppl.). Since Bagdon's store became a Delaware corporation in 1983, Delaware law controls.

Firestone, however, overlooks the choice-of-law clause in the 1981 M & M agreement. The 1981 M & M agreement contained the following clause:

> All questions concerning the validity, interpretation, or performance of any of its terms or provisions or of any rights or obligations of the parties hereto shall be governed by and resolved in accordance with laws of the State of Ohio.

With limited exceptions,[2] Illinois courts enforce choice-of-law stipulations. *Sarnoff v. American Home Products Corp.*, 798 F. 2d 1075, 1081 (7th Cir. 1986); *Wonderlic Agency, Inc. v. Acceleration Corp.*, 624 F. Supp. 801, 803 (N.D. Ill. 1985); *Hofeld v. Nationwide Life Ins. Co.*, 59 Ill. 2d 522, 322 N.E.2d 454, 458 (1975). In fact, it is only when parties fail to make a valid choice of law that courts apply the conflict-of-law rules. *Newman-Green, Inc. v. Alfonzo-Larrain R.*, 605 F. Supp. 793, 796 (N.D. Ill. 1985). And, at least when they signed the contract, the parties made a valid choice that Ohio law would govern. Neither side has offered any reason to abandon the choice-of-law clause (neither party mentions it) and the court can see none. Granted, in 1983 Bagdon's store merged into a newly formed Delaware corporation.

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[2] Illinois courts will enforce the stipulated law "where it is not dangerous, inconvenient, immoral, nor contrary to [Illinois] public policy." *McAllister v. Smith*, 17 Ill. 328, 333 (1856), *quoted in Sarnoff*, 798 F.2d at 1081. More recently, the Illinois Supreme Court has suggested a choice-of-law clause may not be enforced if the provision is unconscionable. *See Hofeld*, 322 F.2d at 458-59. There is no indication any of these conditions apply to this case. There is nothing dangerous, inconvenient, immoral, or contrary to public policy in applying Ohio law to a claim of breach of fiduciary duty. Moreover, Firestone cannot suggest the clause is unconscionable since it drafted the agreement.

The merger documents, though, do not suggest that a new M & M agreement was drafted after the merger.[3]

Indeed, even if the merger purported to modify the choice-of-law clause, the modification would be inoperative since it would have been done without Bagdon's assent. Bagdon specifically states in his affidavit that Firestone never indicated "that the change in the state of incorporation would or could affect my rights and remedies as a minority shareholder." Firestone has not challenged this claim. The law is clear that "[n]o one will be held to have surrendered or modified any of his contract rights unless he is shown to have assented thereto in a manner that satisfies the requirements of a valid contract." Corbin on Contracts § 1293; *see also id.* ("The validity of the substituted contract is determined in the same manner as in the case of any other contract, with respect to such matters as mutual assent and consideration."); *Chicago College of Osteopathy v. Fuller Co.*, 776 F.2d 198, 208 (7th Cir. 1985) (Illinois law) ("A valid modification must meet all the criteria essential for a valid contract: offer, acceptance, and consideration."). Accordingly, the 1983 merger does not supersede the choice-of-law clause in the 1981 M & M agreement.

The court concludes that the choice-of-law clause from the 1981 agreement remains in force. The next question is whether Bagdon's claim for breach of fiduciary duty falls within the scope of this clause. That is, if the claim is a "question[ ] concerning the validity, interpretation or performance of any" term in the agreement, or if it concerns "any rights or obligations of the parties," then Ohio law applies. *See Secon Service System,* 855 F.2d at 412 (choice-of-law clause does not control analysis when litigation involves conduct not covered by the clause).

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[3] The merger documents contain the following provision:

> Upon the merger becoming effective, all the property, rights, privileges ... and other assets of every kind and description of the merged corporation shall be transferred to, vested in and devolve upon the surviving corporation without further act or deed.

Without deciding whether the M & M agreement is property of the corporation, this clause at least suggests that the operation of the new corporation was intended to mirror in all respects the operation of the old corporation. This reinforces the conclusion in the text that the choice-of-law clause remains part of the agreement between the parties.

This is a claim for breach of fiduciary duty. It is axiomatic that majority shareholders, to the extent they control the corporation, owe a fiduciary duty to the minority. Fletcher, Cyc. Corp. §§ 5808, 5810; 5811 (1984) When the minority shareholders allege a breach of this fiduciary duty, it is incumbent on the majority to demonstrate that "the transaction was scrupulously fair." *Id.* at § 5811.10. On the other hand, it is also true that a stockholder's relationship with the corporation is contractual. *Id.* at §§ 5083; 5085 ("The relationship between a corporation and its shareholders has been said to be contractual; requiring a . . . contract giving the right to hold shares . . . and to exercise the rights of a shareholder.").

The relationship between these principles is that, while the majority owes a fiduciary duty to the minority, the scope of that duty is determined by the contract. "[T]he controlling stockholder's fiduciary duty does not expand specific contractual rights . . ., and if the majority shareholder has fully complied with the governing contract provisions, he has discharged his obligations and the fiduciary duty claim is not reached." *Id.* § 5811; *see also id.* ("since a stockholder's relationship with his corporation is contractual, he may be precluded from complaining about discriminatory treatment if he is deemed to have assented to or ratified an agreement providing for that treatment").

From this discussion, it follows that Bagdon's claim for breach of fiduciary duty turns on the terms of the 1981 M & M contract, the provisions of which made Bagdon a minority stockholder. Therefore, his claim necessarily concerns – in the language of the choice-of-law clause – both "the validity, interpretation or performance" of the terms in the agreement, and the "rights or obligations of the parties." Thus, the claim falls within the scope of the clause and Ohio law controls.

Though the law is not well-developed, it appears that, under Ohio law, minority shareholders may recover punitive damages for breach of fiduciary duty owed by the majority, if the conduct was done with malice. *Pohto v. Cresthaven Manor, Inc.* No. 9-238 (Ohio App. 3d September 21, 1984) (LEXIS, States Library, Ohio file). *See also Crosby v. Beam,* No. L-87-198 (Ohio App. 3d July 8, 1988) (LEXIS, State library, Ohio file) (upholding breach of fiduciary duty claim which sought punitive damages).

Firestone's motion for partial summary judgment on Count I is denied.

II. Count II: Fraud

Firestone claims Bagdon cannot, as a matter of law, prove his fraud claim. "The elements of fraud in Illinois are well established

> To prevail in a fraud action the plaintiff must prove: (1) that the defendant made false statements of material fact, and not of opinion; (2) knowing that they were false; (3) intending that the plaintiff rely on them; (4) that plaintiff did rely; (5) that this reliance was justified; and (6) that the plaintiff was damaged thereby."

West v. Western Casualty and Surety Co., 846 F.2d 387, 393 (7th Cir. 1988). Evidently through an overabundance of caution, Firestone challenges Bagdon on each of these six elements.

A. Misrepresentation of Fact

"A statement that merely expresses an opinion or that relates to future or contingent events, rather than past or present facts, does not constitute an actionable misrepresentation." *Id.* Firestone seizes on this principle and argues that any alleged promise that Bagdon would operate the new store was no more than a promise of a future event. Even if the promise were made with the present intention not to perform, the statement is not actionable. *International Meat Co., Inc. v. Bockos*, 157 Ill. App. 3d 810, 510 N.E.2d 1013, 1016-17 (1st Dist.), *leave to appeal denied*, 116 Ill. 2d 559, 515 N.E.2d 109 (1987).

In response, Bagdon relies on the well-established exception to the general rule. Liability can be predicated on the promise of future conduct if the promise is part of a general scheme to accomplish the fraud. The existence of this scheme depends on the totality of the circumstances. *Id.* In this case, Bagdon says Firestone's continued misrepresentations, all to the effect that he would ultimately operate the new store, were part of a scheme to lull Bagdon into accepting, and in fact assist in opening, the new store. According to Bagdon, these misrepresentations

continued well in 1985, nearly two years after the new store opened.

The court agrees with Bagdon that Firestone's actions, viewed in the light most favorable to Bagdon, were part of a scheme to defraud. The longer Firestone could hold off Bagdon, the longer it could operate the new store as a profitable operation. *See General Motors Acceptance Corp. v. Central National Bank,* 773 F.2d 771, 780 (7th Cir. 1985). According to Bagdon, the new store not only created considerable consumer confusion throughout 1983 and into 1984, it also siphoned off sales that otherwise would have gone to him. Yet because Firestone continued to promise him the store, Bagdon did nothing to counter this alleged interference. This is sufficient to support this element of his claim.

B. Knowledge of Falsity

Janet Nicholson, a Firestone employee, testified in her deposition that Firestone decided by February, 1983, that managers of a union Firestone store would not be allowed to manage concurrently a nonunion store. Bagdon's was a union store; the new shop was to be nonunion. From this, a jury would conclude that, at least by the end of February, Firestone knew that Bagdon would not manage both stores. Since the alleged mispresentations continued well after this date, a jury could conclude that Firestone knew the promises were false when made.

C. Reliance

Intent to induce reliance may be inferred from the circumstances. According to Bagdon, senior managers in the Firestone hierarchy told him on repeated occasions that he would manage both stores. Firestone asked him to help in the transition from a J.C. Penney facility to a Firetone outlet and, even after the store opened, continued to tell him he would get the new store. Firestone had never before asked him to assist in the operation of a competing store. And, again according to Bagdon, he was not told of the February decision that managers of union stores could not concurrently manage a nonunion store.

Measured against these facts, a jury could conclude that Firestone intended for Bagdon to rely on its misrepresentations, that Badgon did rely, and that his reliance was justified.

D. Injury

Firestone claims Bagdon suffered no injury. Yet the essence of this count is that Firestone opened a new store, operated it in competition with Bagdon, and siphoned off his customers, all while telling Bagdon the store would be his. Bagdon testified he suffered pecuniary loss as a result of this competition. Bagdon, though, refrained from confronting this competition since he thought he would get the store; he would not have experienced the competition had Firestone made good on its alleged promise. This, if true, is sufficient injury to support the fraud claim.

Firestone's motion for summary judgment on Count II is denied.

III. Count III: Consumer Fraud Act

Count III is a claim under the Illinois Consumer Fraud and Deceptive Business Practices Act. Ill. Rev. Stat. ch. 121 1/2, ¶ 261 *et seq.* Firestone argues first that the claim is time-barred and second that Bagdon cannot as a matter of law prevail under the Act.

A. Statute of Limitations

The Act contains a three-year limitation period. *Id.* at ¶ 270a § 10a(e). The statute of limitations begins to run when a plaintiff first experiences all elements of the cause of action. *Chicago Board of Options Exchange, Inc. v. Connecticut General Life Insurance Co.*, 553 F. Supp. 125, 129 (N.D. Ill. 1982), *rev'd on other grounds*, 713 F.2d 254 (7th Cir. 1983). Bagdon's allegation in this count is that Firestone, by operating two stores in the same shopping center, created consumer confusion, in violation of Ill. Rev. Stat. ch. 121 1/2, ¶ 312(12) (incorporated by reference into the Consumer Fraud Act). According to Bagdon, the confusion began shortly after the new store opened in June, 1983:

> Well, from 1983 to 1984 there was a lot of confusion with customers. They went to the wrong stores. . . . It got to a point where it was really aggravating. . . . It was just a mass confusion between, I would say, the latter part of 1983 and 1984.

Thus by Bagdon's account, he, through his customers, experienced the allegedly unlawful confusion by late 1983. The claim, however, was not filed until May 22, 1987. Firestone therefore claims the action is time-barred.

In response, Bagdon says he avoids the statute of limitations defense because the violation continued until 1984. "[T]he statute of limitations does not begin to run on a continuing wrong till the wrong is over and done with." *Taylor v. Meirick,* 712 F.2d 1112, 1118 (7th Cir. 1983). In this case, Bagdon testified to ongoing customer confusion at least into 1984. This confusion is more than the continuing adverse consequence of a prior wrong; that would not constitute a continuing violation sufficient to toll the statute. *See, e.g., Diliberti v. United States,* 817 F.2d 1259, 1264 (7th Cir. 1987). Rather, each incident of customer confusion is, under the Illinois statute, a potentially actionable wrong. *Unique Concepts, Inc. v. Manuel,* 669 F. Supp. 185, 191 (N.D. Ill. 1987). Since Firestone cannot demonstrate that the wrong was "over and done with" prior to May 22, 1984, it cannot prove the affirmative defense and the claim is not time-barred.

B. Consumer Fraud Claim

Firestone next argues that Bagdon cannot satisfy the essention elements of a claim under the Consumer Fraud Act. Firestone makes two arguments. The first is that the Act requires an adverse affect on consumers generally, and not merely on individual business people. *Nanlawala v. Jack Carl Assocs., Inc.,* 669 F. Supp. 204, 211 (N.D. Ill. 1987).[4] Since, according to Firestone, this dispute reduces to a controversy between business people, there is no claim under the Act.

The difficulty with this view is that the Act expressly incorporates Section 2 of the Uniform Deceptive Trade Practices Act. That is, the Consumer Fraud Act provides in relevant part:

---

[4] There is considerable disagreement over this proposition. A number of Illinois appellate court decisions do not require injury to consumers. *See, e.g., Duncavage v. Allen,* 147 Ill. App. 3d 88, 497 N.E.2d 433, 441 (1st Dist. 1986), *leave to appeal denied,* 505 N.E.2d 352 (1987). Most judges in the Northern District of Illinois, however, do impose this requirement. *See Maduff v. Life Ins. Co. of Virginia,* 657 F. Supp. 437, 440 (N.D. Ill. 1987) (discussing split in authority).

> Unfair methods of competition and unfair or deceptive acts or practices, including but not limited to the use or employment . . . of any practice described in Section 2 of the "Uniform Deceptive Trade Practices Act", . . . are hereby declared unlawful. . . .

Ill. Rev. Stat. ch. 121 1/2, ¶ 262.

And Section 2 of the Uniform Deceptive Trade Practices Act provides in relevant part:

> A person engages in a deceptive trade practice when, in the course of his business, vocation or occupation, he:
>
> * * *
>
> (12) engages in any other conduct which . . . creates a likelihood of confusion or misunderstanding.
>
> In order to prevail under this Act, a plaintiff need not prove competition between the parties or actual confusion or misunderstanding.

A jury could reasonably conclude that Firestone, by opening the new store rather than leasing it to a non-automotive facility, and by failing to distinguish clearly between the stores in its advertisings and promotions, created a likelihood of consumer confusion. In addition, though not required under the statute, Bagdon testified to repeated instances of actual confusion. This is sufficient injury to consumers generally.

Firestone's second argument is that Bagdon has adduced no evidence of any intent to confuse. But the plain language of the statute indicates that intent is not an element of a claim for consumer confusion. The Consumer Fraud Act prohibits two categories of conduct. The first is unfair competition done with the intent that others rely on the unfair conduct. The second category, however, requires no showing of intent, and broadly proscribes "the use or employment of any practice described in Section 2 of the Uniform Deceptive Trade Practices Act. . . ." Section 2 in turn has no intent requirement. Bagdon's claim of consumer confusion falls under this second category, and

therefore has no intent requirement. *See Zeller v. Laltood,* 627 F. Supp. 55, 61 (C.D. Ill. 1985) (liability under statute requires no intent to deceive.)

Firestone's motion for summary judgment on Count III is denied.[5]

IT IS THEREFORE ORDERED that:

(1) Defendant's motion for summary judgment is denied.

(2) A status hearing is set for March 15, 1989 at 9:15 a.m.

ENTER:

/s/ WILLIAM T. HART
UNITED STATES DISTRICT JUDGE

Dated: MARCH 8, 1989

[5] Firestone also claims Bagdon is not entitled to punitive damages under Counts II and III because there is no evidence of malice or ill will. The court defers ruling on this matter until the close of the plaintiff's case.

In The
United States District Court
For the Northern District of Illinois
Eastern Division

EDWARD F. BAGDON,
Plaintiff,

v.

THE FIRESTONE TIRE & RUBBER COMPANY, an Ohio corporation,
Defendant.

No. 87 C 4698,
Honorable
William T. Hart

FINAL PRETRIAL ORDERD

This matter having come before the Court at a pretrial conference held pursuant to Fed. R. Civ. P. ("Rule") 16, and

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having appeared as counsel for plaintiff and

Paul W. Schroeder
Cheryl L. Urbanski
Jones, Day, Reavis & Pogue
225 West Washington Street
Chicago, Illinois 60606
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having appeared as counsel for defendant, the following action was taken:

This is an action for damages based on Defendant's alleged breach of fiduciary duty, fraud, and violation of the Illinois Consumer Fraud and Deceptive Business Practices Act, Ill. Rev. Stat; ch. 121 1/2, ¶261, *et seq.*

The jurisdiction of the Court is invoked under 28 U.S.C. §1332. Jurisdiction is disputed by Firestone which contends that Firestone Stores of Chicago-Ford, Inc., is an indispensable party, whose joinder would defeat diversity.

All the following stipulations and statements were submitted and are attached to and made a part of this Order:

7. Did Bagdon sustain damages as a result of Firestone's fraudulent misrepresentations?

10. Did Firestone make material misrepresentations or deceptive statements to Bagdon?

11. Did Firestone violate the Illinois Consumer Fraud and Deceptive Practice Act?

12. Did Bagdon sustain damages as a result of Firestone's violation of the Illinois Consumer Fraud and Deceptive Practices Act?

FIRESTONE'S STATEMENT OF CONTESTED ISSUES OF FACT

1. Did Firestone breach its fiduciary duty to plaintiff by usurping a corporate opportunity belonging to Firestone Stores of Chicago - Ford, Inc.?

2. If Firestone breached its fiduciary duty to plaintiff, has plaintiff been damaged and, if so, what is the measure of those damages?

Firestone reserves the right to supplement these contested issues of fact in the event its pending motion for partial summary judgment is denied.

BAGDON'S STATEMENT OF CONTESTED ISSUES OF LAW

1. Is Bagdon entitled to punitive damages as a result of Firestone's breach of its fiduciary duties?

2. Is Bagdon entitled to punitive damages as a result of Firestone's fraudulent misrepresentations?

3. Is Bagdon entitled to punitive damages as a result of Firestone's violation of the Illinois Consumer Fraud and Deceptive Practices Act?

FIRESTONE'S STATEMENT OF CONTESTED ISSUES OF LAW

1. Does Delaware law control whether Firestone has breached any fiduciary duty to plaintiff?

2. Is Firestone Stores of Chicago - Ford, Inc., an indispensable party, whose joinder will defeat diversity jurisdiction?

Firestone reserves the right to supplement these contested issues of law in the event its pending motion for partial summary judgment is denied.

(c) schedules of (i) all exhibits (all exhibits shall be marked for identification before trial), including documents, summaries, charts and other items expected to be offered in evidence and (2) any demonstrative evidence and experiments to be offered during trial;

EXHIBITS

1. The following exhibits were offered by Plaintiff, received in evidence and marked as indicated:

Exhibits 2(d), 2(e), 2(g), 2(h), 2(i) and 2(j): Advertisements.

Exhibits 3(b) and 3(c): Yellow Pages Advertisements.

Exhibits 4(a) through 4(h): Shugan Deposition Exhibit No. 6.

Exhibits 5(a) through 5(h): Lindeman Deposition Exhibit No. 3.

Exhibit 6: 1971 Shareholder Agreement Between Bagdon and Firestone.

In The
United States District Court
For the Northern District of Illinois
Eastern Division

EDWARD F. BAGDON,
Plaintiff,

v.

THE FIRESTONE TIRE & RUBBER COMPANY, an Ohio corporation,
Defendant.

No. 87 C 4698,
Honorable
William T. Hart

Defendant's Proposed Jury Instructions

Defendant, The Firestone Tire and Rubber Company ("Firestone"), hereby submits its Proposed Jury Instructions. Firestone reserves the right to supplement and modify those Proposed Jury Instructions.

THE FIRESTONE TIRE & RUBBER COMPANY,

By: /s/ CHERYL L. URBANSKI
One of Its Attorneys

Paul W. Schroeder, Esq.
Cheryl L. Urbanski, Esq.
JONES, DAY, REAVIS & POGUE
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In this case, plaintiff Mr. Bagdon was and is the minority shareholder in Firestone Stores of Chicago-Ford, Inc., which is also known and referred to as Ford City West. Defendant, The Firestone Tire & Rubber Company was and is the majority shareholder in that corporation. You are instructed that a fiduciary relationship exists between The Firestone Tire & Rubber Company as majority shareholder and Mr. Bagdon as minority shareholder.

The fiduciary relationship imposed a duty upon defendant to deal fairly and honestly with plaintiff and not to usurp or seize corporate opportunities which belong to the corporation in which plaintiff and defendant are shareholders.

The essential elements to finding that a corporate opportunity has been seized or usurped are:

(1) that a corporate opportunity was taken advantage of by Firestone in its official capacity as a majority shareholder rather than its individual capacity as a worldwide tire manufacturer and supplier of automotive repair services;

(2) that the corporation in which plaintiff and defendant are shareholders was financially able to take advantage of the opportunity itself; and

(3) that the opportunity was either essential to the corporation in which plaintiff and defendant are shareholders or is one in which it had an interest or tangible expectancy.

Firestone is free to engage in an independent business which is the same or similar to the business of the corporation in which Firestone and Mr. Bagdon are shareholders so long as it violates none of these legal duties imposed upon it with respect to the fiduciary relation that exists between Firestone and Mr. Bagdon.

In Count I, plaintiff Mr. Bagdon claims that Firestone violated the fiduciary duty owed to him as minority shareholder by not closing the Firestone Store in the Ford City shopping Center in Chicago. It is for you to determine whether Firestone violated its fiduciary duties to deal fairly and honestly with Mr. Bagdon. However, Firestone had no duty to disclose matters within the knowledge of Mr. Bagdon.

If you find by clear and convincing evidence that defendant breached its duties as a majority shareholder, you must determine what damages, if any, were proximately caused by such acts which constituted the breach of duty.

If you should find that the plaintiff is entitled to a verdict, you may award the plaintiff only such damages as will reasonably compensate for such injury and damage as you find, by clear and convincing evidence, that plaintiff has sustained as a proximate result of the acts of the defendant.

Defendant's Instr. No. 28
3 Devitt, Blackmar and Wolff, *Federal Jury Practice and Instructions*, § 83.06 (4th ed. 1987) (modified); *Schreiber v. Bryan*, 396 A.2d 512, 519 (Del. Ch. 1978); *Worth v. Huntington Bancshares*, No. 52861, (Court of Appeals, Cuyahoga County, November 25, 1987); *Pohto v. Cresthaven Manor, Inc.*, No. 9-238 (Court of Appeals, Eleventh District, Lake County, September 21, 1984); *Wing Leasing v. M&B Aviation*, 1988 Ohio App. LEXIS 906, 31 (1988); Ohio Rev. Code § 1701.59 (1987).

In The United States District Court For the Northern District of Illinois Eastern Division

EDWARD F. BAGDON,
Plaintiff,

v.

THE FIRESTONE TIRE & RUBBER COMPANY, and Ohio corporation,
Defendant.

No. 87 C 4698,
Honorable
William T. Hart

I. Statement of Facts.

Bagdon incorporates by reference his Rule 12(f) Statement, a copy of which is attached for the Court's convenience.

II. Illinois Law Governs Plaintiff's Claim That Firestone Breached Its Fiduciary Duty (Count I).

Firestone's motion and briefs rest solely on the false premise that Delaware law controls because the parties' corporation, Firestone Stores of Chicago-Ford, Inc. ("Chicago-Ford, Inc."), is today a Delaware corporation. Significantly, Firestone fails to tell the Court that Chicago-Ford, Inc. *was an Illinois corporation, not a Delaware corporation, at the time of the operative acts giving rise to liability.* Firestone, the majority shareholder, changed the state of incorporation only *after* it had embarked upon its unconscionable course of conduct and had committed most of the tortious acts at issue, including opening a competing, company-owned Firestone store in the same shopping center as the Firestone store operated by Chicago-Ford, Inc. (12(f) Stmt., pars. 11-29) Moreover, even if that change had occurred prior to Firestone's unlawful acts, and it did not, Illinois choice of law rules require application of Illinois, not Delaware, law. Illinois allows punitive damages where, as here, a majority shareholder

breaches fiduciary duties owed to a minority shareholder. *Grahm v. Mimms*, 111 Ill. App. 3d 751 (1st Dist. 1982); *Zokoych v. Spalding*, 36 Ill. App. 3d 654, 671 (1st Dist. 1976).

A. Chicago-Ford, Inc., Was An Illinois Corporation At The Time Firestone Breached Its Fiduciary Duties.

Firestone incorporated Chicago-Ford, Inc., in 1970 as an Illinois corporation. That corporation did business as an Illinois corporation for more than 12 years. Its sole business was operating the Firestone store at 7615 S. Cicero Avenue in the Ford City Shopping Center. (Bagdon Dep., pp. 40-41, 71) In 1983, Firestone decided to change the state of incorporation by merging Chicago-Ford, Inc., into a newly formed Delaware corporation with the same name. (12(f) Stmt., par. 30, attached) Significantly, the Agreement of Merger which Firestone drafted, *by its terms*, specifies that the merger would not be effective until the agreement was filed with the Delaware Secretary of State. (12(f) Stmt., par. 30; PX8, p. 4, par. 4(b), attached)[6] Firestone did not so file the Agreement until August 15, 1983. (12(f) Stmt., par. 30; PX8, p.1) Hence, the company did not even become a Delaware corporation until August 15, 1983, well *after* June, 1983, when Firestone opened the competing store in the former J.C. Penney facility in the Ford City Shopping Center. Firestone opened this store even though it was only 700 yards from plaintiff's store and Firestone's own feasibility studies (conducted between January and March, 1983) showed that the new store would create a "severe conflict" with Bagdon's store and that Bagdon's store was "too close to [the new facility] for both to be operated successfully by Firestone." 12(f) Stmt., par. 13) Even before June, 1983, Firestone officials falsely told Bagdon he was the manager of the new store, obtained his assistance in setting it up, and then refused to allow him to participate in it. (12(f) Stmt., pars. 14-19) Therefore, because Firestone Stores was still an Illinois corporation at the time Firestone breached its fiduciary duties, there can be no question but that Illinois (and not Delaware) law governs here.

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[6] "PX" denotes Plaintiff's Exhibits and "DX" denotes Defendant's Exhibits. All exhibits cited are in evidence unless noted and are attached to Plaintiff's Rule 12(f) Statement of Facts.

That Firestone continued to breach its fiduciary duty even after changing the state of incorporation hardly compels the application of Delaware law. Firestons's manipulation of the state of incorporation was itself a breach of the fiduciary duty which Firestone concededly owed to Bagdon, because Firestone never told Bagdon that the change would or might affect his rights and remedies as a minority shareholder. (Bagdon Aff., par. 9) Hence, to apply Delaware law would ignore Firestone's oppressive conduct in unilaterally changing the state of incorporation and would allow Firestone to profit from its breach of duty.

B. Illinois Choice of Law Rules Compel Application of Illinois Law.

Even if Chicago-Ford, Inc., had been a Delaware corporation when Firestone breached its fiduciary duty, it would *not* follow that Delaware law applies.[7] As Firestone concedes, Illinois courts have not determined the choice of law rules applicable to a minority shareholder's breach of fiduciary duty claim against a majority shareholder. Accordingly, this Court must determine what rule the Illinois Supreme Court would adopt, if the issue was presented. *Erie Railroad Co. v. Tompkins*, 304 U.S. 64 (1938); *White v. United States*, 680 F.2d 1156, 1161 (7th Cir. 1982) Clearly, the Illinois Supreme Court would adopt the well-reasoned approach set forth in §306 of the Restatement (Second) of Conflict of laws.

Section 306 Provides:

> The obligations owed by a majority shareholder to the corporation and to the minority shareholders will be determined by the local law of the state of incorporation, *except* in the unusual case where, with respect to the particular issue, some other state has a more

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[7] Firestone's cases are distinguishable and not binding on this Court. They involved claims against officers and directors, not majority shareholders. *Paulman v. Kritzer*, 74 Ill. App. 2d 284 (2d Dist. 1966); *Dwyer v. Tracey*, 118 F. Supp. 289 (N.D. Ill. 1954). They were decided *well before* the judicial recognition of the fiduciary relationship between majority and minority shareholders in a close corporation. Those cases also applied the general rule without discussion since the courts were not faced with the question of whether to apply the law of a state *other* than the state of incorporation.

> significant relationship . . . to the parties and the corporation, in which event the local law of the other state will be applied.

Restatement (Second) of Conflict of Laws §306 (1971 and 1986 Suppl.) (emphasis supplied).

Comment c of Section 306 provides:

> The local law of some state other than the state of incorporation is most likely to be applied in a situation where the corporation does all, or nearly all, of its business and has most of its shareholders in that other state and has little contact, apart from the fact of its incorporation, with the state of incorporation.

Comment c epitomizes this case.

Delaware has *no* connection with this litigation, apart from the naked fact that Firestone decided to incorporate Chicago-Ford, Inc., there *after* it embarked on its oppressive course of action against Bagdon. The corporation does no business and has never done any business in Delaware. It has no facilities, property, place of business, revenue, shareholders or employees there. *None* of the operative acts giving rise to this suit occurred in Delaware. In contrast, Chicago-Ford, Inc., has at all times operated exclusively in Chicago. It derives all of its revenues here and its business, property and employees are here. The significant contacts and the relationship between the parties are centered exclusively in Illinois. Both parties currently reside here. All of the operative acts in breach of Firestone's fiduciary obligations occurred here.

In similar cases where only the "naked fact of incorporation" was found in the state of incorporation, courts have applied the law of the state which has the most significant contacts to the parties and the litigation. *Mansfield Harwood Lumber Co. v. Johnson*, 268 F.2d 317, 321 (5th Cir. 1959), *cert. denied* 361 U.S. 885 (1959). *See also Kohn v. American Metal Climers, Inc.*, 458 F.2d 255, 302 n. 58 (3d Cir. 1972), *cert. denied* 409 U.S. 874; *Blazer v. Black*, 196 F.2d 139 (10th Cir. 1952). Because nothing connects this case with Delaware and everything connects it with Illinois, Illinois law and *not* Delaware law applies to plaintiff's claim.

Not only is Restatement (Second) §306 consistent the older Illinois cases citing the general rule, it is also consistent with the trend in Illinois may from "bright-line" choice of laws rules and toward a more reasoned analysis of the relevant contacts. For example, Illinois has abandoned the "lex loci delicti" test for conflicts questions involving intentional torts, in favor of the Restatement's "significant relationship" approach. *Ingersoll v. Klein*, 46 Ill. 2d 42, 48 (1973). Similarly, federal courts have recognized that Illinois would adopt the Restatement approach in cases involving the availability of punitive damages in wrongful death actions, *In re Air Crash Disaster Near Chicago, Illinois*, 644 F. 2d 594 (7th Cir. 1981) and breach of contract claims, *Barry Gilberg, Ltd. v. Craftex Corp., Inc.*, 665 F.Supp. 585, 590 (W.D.Ill. 1987).

Firestone does not and cannot contend that, if Illinois law is applied, Bagdon has not brought forth enough evidence to mandate sending his claim for punitive damages to the jury. Instead it merely claims that the punitive damage claim under Count I is precluded as a matter of law by the application of Delaware law. Since that issue is easily disposed of, Firestone's motion on Count I must be denied.[8]

III. There is Substantial Evidence To Support Plaintiff's Claim of Fraudulent Misrepresentation (Count II).

Firestone's arguments concerning plaintiff's burden of proof at trial are irrelevant. Bagdon is not required to "prove" his case in response to this motion. He is merely required to present sufficient evidence to establish a genuine issue of material fact. *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242 (1986). It is enough that, examining the evidence in a light most favorable to plaintiff, Bagdon has presented substaintial evidence to support a jury verdict in his favor on each and every element of his fraud claim. *Id.*

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[8] Therefore, it is unnecessary to determine whether Firestone's statement of Delaware law was in fact correct. Plaintiff does not concede its accuracy.

A. Firestone Made False Statements of Existing Material Facts.

Firestone does not dispute that it made material misrepresentations that Bagdon would manage and operate the new store. Instead, Firestone characterizes them as mere statements of future intent. Thus, Firestone overlooks significant portions of plaintiff's testimony, ignores the admissions of its management personnel and glosses over the circumstances surrounding its misrepresentations.

In The
United States Court of Appeals
For the Seventh Circuit

NOS. 89-3724 AND 89-3774

EDWARD F. BAGDON,
Plaintiff-Appellee and Cross-Appellant,

v.

THE FIRESTONE TIRE & RUBBER COMPANY,
Defendant-Appellant and Cross Appellee.

Appeal from the United States District Court for The Northern District of Illinois, Eastern Division

87 C 4698

The Honorable **William T. Hart,** Judge Presiding.

BRIEF OF APPELLEE AND CROSS-APPELLANT

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Firestone has been compelled to waive the issue of liability on appeal and does not now deny that it was a wrongdoer.

B. The Parties' Corporation Was Not A Necessary Party.

Desperately attempting to delay having to pay for its admittedly oppressive conduct, Firestone asserts that the parties' corporation was a "necessary party". However, this contention was properly rejected by the trial court and has no more merit now than before. (R. 20) As the trial court recognized, Firestone merely seeks to exalt form over substance; the corporation's interests are obviously protected by the presence of its only stockholders. (R. 20) Moreover, Firestone cannot deny that Bagdon pled and proved sufficient individual injuries such as lost dividends, bonuses and other detriments to allow him to proceed individually, rather than derivatively.

Without *any* authority, Firestone next argues that, despite having proved his lost bonuses without any objection from Firestone, Bagdon cannot recover them because he did not earn them in his capacity as a shareholder. No court has allowed a fiduciary which has breached its duties to escape liability on the basis of such an artifical distinction. Indeed, the Restatement of Torts explicitly recognizes that fiduciaries such as Firestone are liable for *all* foreseeable damages which flow from their breaches of fiduciary duties. Restatement (Second) of Torts, §874 (1982). See also, *Marquis Theatre Corp. v. Condado Mini Cinema*, 846 F.2d 86, 92 (1st Cir. 1988); *Decision Services Consultants, Inc. v. Blumberg*, 1987 U.S. Dist. LEXIS 295 (E.D. Pa. 1987) (a copy is attached in Appendix, pp. 85-92).

C. The Damage Award Is Well Supported By The Evidence.

Conceding liability, as it must, Firestone also attempts to avoid having to pay for its misdeeds by misstating the record and the law in the hope of obfuscating the sound theoretical and factual underpinnings for plaintiff's damage calculations. But, Firestone cannot deny that the $306,995 aware after remittitur is precisely the amount which the plaintiff's experts testified as the *absolute minimum* damages plaintiff suffered in

damages as a result of Firestone's admitted breach of its fiduciary duties. (R. 173-6, pp. 754-55) Their testimony alone is more than enough to support the award. *Johnson v.* plaintiff, merely and adjoining land owner – for its decision to demolish its own building "arguably in face of and disagreeing with the report indicating" that it might injure plaintiff's property. Slip op. at 5-6. In *Pohto v. Cresthaven Manor, Inc.*, No. 9-238, slip op. (Ohio App. Ct. Sept. 21, 1984) (a copy is attached in Appendix, pp. 93-96), a case virtually "on all fours" with the instant case, the Ohio Appellate Court affirmed an award of punitive damages where the majority shareholder in a construction company set up a competing operation and made fraudulent misrepresentations to the minority shareholder about the financial condition of their corporation in order to placate him while the majority shareholder took over the business for himself. Slip op. at 3-4. Likewise, in *Wing Leasing, Inc. v. M&B Aviation, Inc.*, 44 Ohio App. 3d 178, 342 N.E.2d 671 (1988), a case decided after *Preston*, the court refused to vacate an award of punitive damages where the majority shareholder set up a rival operation to perform airplane maintenance which had been done by the parties' corporation.[9] *Id.*

Here, as in *Digital & Analog Design Corp.*, there was substantial evidence that, in planning its action in advance,

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[9] The trial court's misinterpretation of Ohio law regarding punitive damages is consistent with (and perhaps caused by) its erroneous holding the Firestone's fiduciary duties as governed by the choice-of-law provision in the parties' 1981 M&M agreement, which is completely silent about the Firestone's fiduciary obligations. (R. 91), Indeed, courts have recognized that fiduciary obligations which arise by operation of law since they are distinct from contact rights:

> relievf[e] the parties to such relationships of the obligation of, in every case, individually negotiating contracts which specify the fiduciary's duties in a large number of hard-to-anticipate situations.

Graham v. Mimims, 111 Ill.App. 3d 751, 760 (1st Dist. 1982). Under traditional choice of law principles, the trial court should have applied Illinois law here. *Treco, Inc. v. Land of Lincoln Savings and Loan*, 749 F. 2d 374, 377 (7th Cir. 1984); Restatement (Second) of Conflicts, §306. is similar to Ohio law and would undoubtedly allow the question of punitive damages to go to the jury. See e.g., *Graham*, 111 Ill. App. 2d at 760; *Zokoych v. Spalding*, 36 Ill. App. 3d 654, 671 (1st Dist. 1976). Thus, the trial court's application of Ohio law was but one error underlying its improper denial of punitive damages.

Firestone knew its actions would harm Bagdon's business. As Juergens and Intorre testified, Firestone was well aware of the concept of cannibalization and had received numerous reports from Juergens, Dolan and others that the wholly owned competing store only 700 yards would siphon business from Bagdon's

No. 90-1290

FILED
MAY 8 1991
OFFICE OF THE CLERK

IN THE
SUPREME COURT OF THE UNITED STATES
OCTOBER TERM, 1990

EDWARD F. BAGDON,

Petitioner,

v.

BRIDGESTONE/FIRESTONE, INC.,

Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit

---

RESPONDENT'S BRIEF IN OPPOSITION

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Counsel for Respondent.
** Counsel of Record.*

QUESTIONS PRESENTED

1. Whether, when state law vests a cause of action in a corporation, the corporation is an indispensable party in a shareholder derivative action.

2. Whether the Court of Appeals correctly interpreted state law in holding that a minority shareholder must proceed derivatively on a claim for breach of fiduciary duty.

RULE 29.1 LIST OF AFFILIATED CORPORATIONS

The parent company of respondent Bridgestone/Firestone, Inc. is Bridgestone Corporation, a Japanese corporation. Bridgestone/Firestone, Inc.'s domestic subsidiaries (other than wholly owned subsidiaries) are Delta Holdings, Inc., Schottler Tire, Firestone Stores of Bay City, Inc., and Firestone Stores of Chicago-Ford, Inc. Its foreign subsidiaries are Hopewell International Insurance Ltd., a Bermuda corporation; United Insurance Co., a Bermuda corporation; Corporate Officers & Directors Assurance Holding Ltd., a Bermuda corporation; Corporate Officers & Directors Assurance Ltd., a Bermuda corporation; Bridgestone/Firestone Canada, Inc., a Canadian corporation; Firestone East Africa (1969) Limited, a Kenyan corporation; Liberian Bank for Development and Investment, a Liberian corporation; Lone Star Transport Lines, Inc., a Liberian corporation; Liberian Metal Processing Incorporated, a Liberian corporation; Bridgestone/Firestone de Mexico, S.A., a Mexican corporation; Firestone N.Z. Limited, a New Zealand corporation; and Philtread Tire & Rubber Corp., a Philippine corporation.

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No. 90-1290

IN THE
SUPREME COURT OF THE UNITED STATES
OCTOBER TERM, 1990

EDWARD F. BAGDON,

Petitioner,

v.

BRIDGESTONE/FIRESTONE, INC.,

Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit

RESPONDENT'S BRIEF IN OPPOSITION

Respondent, Bridgestone/Firestone, Inc. ("Firestone"), respectfully requests the Court to deny the petition for a writ of certiorari, filed on February 11, 1991, to review the judgment of the United States Court of Appeals for the Seventh Circuit entered on October 17, 1990.

STATEMENT OF THE CASE

Petitioner, Edward Bagdon, and respondent, Bridgestone/Firestone, Inc.,[1] were the two stockholders in Firestone Stores of Chicago-Ford, Inc. ("Stores"), a Delaware close corporation. Petitioner owned 49 percent of the stock and respondent owned 51 percent. Stores operated a Firestone auto service store in the Ford City Shopping Center on the southwest side of Chicago. Petitioner managed the store and was an employee of respondent as well as co-owner of Stores. Stores was originally incorporated in Illinois, but, with petitioner's agreement, was reincorporated in Delaware in 1983. [2] (Pet. Appx. 2a.) It had its principal place of business in Illinois.

In the early 1980s, J.C. Penney, which also operated auto service stores, decided to exit the auto service business. In 1983, respondent bought or leased all of Penney's free-standing stores, including one in the Ford City Shopping Center (the "Penney store"). The Penney store was located at the other end of the Center about 700 yards from the Stores location. (Pet. Appx. 2a.)

In reliance on studies, information and recommendations received from its field personnel, Firestone management decided that Ford City could support two stores. On June 1, 1983, the Penney store began operations under the Firestone name. However, after the conversion of the Penney store, the economic situation at Ford City deteriorated and the business of both Ford City Firestone outlets declined. (Pet. Appx. 3a.)

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1 Bridgestone/Firestone, Inc. was formerly known as Firestone Tire & Rubber Co.

2 All references herein which are designated by "Pet. Appx." refer to the Appendix filed with the Petition. All references designated by "Pet." refer to the Petition.

Four years later, in 1987, petitioner commenced a diversity action against the respondent in the United States District Court for the Northern District of Illinois. The only named defendant was respondent; petitioner did not join Stores as a party. Petitioner was a citizen of Illinois, and respondent was a citizen of Ohio. Naming Stores would have destroyed diversity because its principal place of business was in Illinois. *See* 28 U.S.C. § 1332(a). (Pet. Appx. 3a-4a.)

The Complaint asserted two causes of action purportedly based on petitioner's employment relationship with respondent (Counts II and III), and a cause of action (Count I) alleging that respondent as majority stockholder had breached its fiduciary duty to petitioner as minority stockholder by establishing the Penney store in competition with Stores. (Pet. Appx. 4a-5a.) Ultimately, the District Court directed a verdict for respondent on Counts II and III, and the petition concerns only Count I. (Pet. Appx. 5a.)

At the inception of the proceeding, on July 9, 1987, respondent moved to dismiss Count I of the Complaint on the ground that Stores was an indispensable party, required to be joined under Rule 19 of the Federal Rules of Civil Procedure. (Pet. Appx. 3a.) On October 8, 1987, the District Court denied the motion, finding that:

> Under Rule 19(b) the inquiry is "whether in equity and good conscience the action should proceed among the parties" or whether the absent person is indispensable, mandating dismissal of the action. Four factors must be considered: (1) the prejudicial effect of a

> judgment rendered in the absence of the party; (2) the extent to which such prejudice may be avoided; (3) the adequacy of the judgment in the party's absence; and (4) the availability of an adequate remedy if the action is dismissed. In this case, defendant has not shown that [Stores] is an indispensable party to this action under these four factors. [3]

(Pet. Appx. 18a; citation omitted.) After a jury trial, the District Court entered judgment for petitioner on Count I in the amount of $306,995.

On respondent's appeal, the Seventh Circuit reversed, holding that Stores was indeed an indispensable party to the action. Initially, the Court of Appeals looked to Rule 19, concluding:

> Rule 19 is *not* "applied pragmatically" in derivative cases. If this is a derivative suit, the corporation is an indispensable party. So much has been settled since *Davenport v. Dows*, 85 U.S. (18 Wall.) 626 (1873), a decision reaffirmed after the adoption of Rule 19. *Koster v. (American) Lumbermens*

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3 In determining that the action could proceed without Stores, the District Court found that Stores would not be prejudiced because both of its shareholders were parties in the case, that an adequate judgment could be rendered in the absence of Stores since no other party would seek redress against defendant Firestone after the action was resolved and that, while the availability of the alternative Illinois forum renders a Rule 19(b) dismissal less onerous, the availability of an alternative remedy was not sufficient, standing alone, for deciding that the action should not proceed. (Pet. Appx. 18a-19a.)

Mutual Casualty Co., 330 U.S. 518, 522-23 n.2 (1947).

(Pet. Appx. 6a.) The Seventh Circuit then held as a matter of state law that the Illinois courts would apply Delaware law to determine whether a minority shareholder could maintain an individual action against the majority shareholder when it claims that the majority shareholder wrongly competed with the corporation, thereby depriving the minority shareholder of the benefits of its investment. Concluding that no such action could be maintained under Delaware law, and that the action could be maintained only by the corporation, the Court of Appeals held that Stores was an indispensable party. (Pet. Appx. 7a-11a.) This petition followed.

I. The Court Of Appeals Holding With Respect To Rule 19 Does Not Conflict With Of Any Decision Of This Court Or Of Any Other Court Of Appeals And Faithfully Applies This Court's Past Decisions.

Citing *Provident Tradesmens Bank & Trust Co. v. Patterson*, 390 U.S. 102 (1968), and C. Wright, A. Miller and M. Kane, *Federal Practice and Procedure: Civil 2d*, § 1601, p. 15 (1986), petitioner asserts an inconsistency between prior interpretations of Rule 19 of the Federal Rules of Civil Procedure and the Court of Appeals' ruling that corporations are indispensable parties in shareholder derivative actions. A review of these authorities shows no such inconsistency.

Petitioner argues that this Court's decision in *Provident Tradesmens Bank v. Patterson*, 390 U.S. 102

(1968), requires a "pragmatic" application of Federal Rule of Civil Procedure 19, and that the Court of Appeals' decision was not "pragmatic" because it did not contain a discussion of the "four overlapping factors" set forth in Section (b) of the Rule. (Pet. at 7, 11-13.) But *Provident Tradesmens Bank* was not a derivative action, and the language petitioner quotes from *Provident Tradesmens Bank* expressly recognized that "[t]he decision whether to dismiss (i.e., the decision whether the person missing is 'indispensable') must be based on factors varying with the different cases, some such factors being . . . *compelling by themselves*." 390 U.S. at 118-19 (emphasis added). [4]

In this case, the derivative nature of petitioner's claim under state law was a "compelling factor" requiring dismissal. A shareholder's suit that is derivative under state law simply cannot be maintained without joinder of the corporation. *City of Davenport v. Dows*, 85 U.S. (18 Wall) 626 (1873); *Koster v. (American) Lumbermens Mut. Cas. Co.*, 330 U.S. 518, 522-23 n.2 (1947). As the Court noted in *Dows*:

> The relief asked [in a derivative action] is on behalf of the corporation, not the individual shareholder, and if it be granted[,] the complainant derives only an incidental benefit from it. . . . [A] court of equity will not take cognizance of a bill brought to settle a question in which the corporation is the

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4 Similarly, as the Committee Notes to the 1966 Amendments to Rule 19 observe, the factors listed in Rule 19(b) were never intended to "exclude considerations which may be applicable in particular situations."

> essential party in interest, unless it is made a party to the litigation.

85 U.S. at 627. Because the corporation in this case could not be joined without defeating the only basis for subject matter jurisdiction -- diversity of citizenship -- the Court of Appeals' decision was correct.

Petitioner suggests that the 1966 amendments to Rule 19 have somehow changed this Court's view of derivative suits. (Pet. at 8.) But while Committee Notes to the amended rule urge each court to consider the option of exercising "power to adjudicate as between the parties already before it," there has been no change in this Court's view, first expressed in *Dows*, that a corporation is the only real party in interest in a derivative suit:

> The corporation is a necessary party to [a derivative] action; without it the case cannot proceed. Although named a defendant, it is the real party in interest, the stockholder being at best the nominal plaintiff. The proceeds of the action belong to the corporation and it is bound by the result of the suit. The heart of the action is the corporate claim.

Ross v. Bernhard, 396 U.S. 531, 538-39 (1970). Thus, once it became clear that petitioner's Count I was entirely derivative and that the corporation could not be joined, the District Court lacked jurisdiction to adjudicate Count I.

Petitioner is similarly unsuccessful in relying on the *Federal Practice and Procedure* treatise to show conflict among the circuits regarding the necessity of joining a corporation in a derivative action. The general discussion of "pragmatism" cited by petitioner is followed by a specific discussion of the application of Rule 19 to shareholders' suits. 7 C. Wright, A. Miller, M. Kane, *Federal Practice and Procedure*, § 1615, pp. 230-31 (1986). In the latter discussion, the authors note: "When [joinder] is not feasible, either because the corporation is not subject to service of process or its joinder would destroy diversity jurisdiction, the corporation has been regarded as an indispensable party and the action dismissed." No contrary authority is cited. *Moore's Federal Practice* says the same thing:

> In a derivative or secondary action by corporate stockholders against an outsider or the officers or directors of the corporation for wrongful injury to the corporation, *the corporation, if a going concern, is an indispensable party*, because the primary right sued on is that of the corporation, recovery normally accrues to it, and the stockholders are only secondarily interested.

3A *Moore's Federal Practice*, para. 19.13[1], 19-224-226 (emphasis supplied; footnote omitted). *See also* 3B *Moore's Federal Practice*, para. 23.1.21[1], 23.1-100 ("the corporation, if a going concern, must be made a defendant, since it is indispensable, even though the plaintiff sues upon a right which belongs to the corporation" (footnote omitted)). Again, no contrary authority is noted.

Petitioner has cited no cases or other authorities to the contrary. The decision below was fully consistent with the decisions of this Court and of the lower federal courts, and the law in this area is clear. [5]

II. The Court Should Not Grant Review To Decide Issues Of State Law.

Petitioner also urges this Court to grant certiorari to determine whether, under *Erie Railroad Co. v. Tompkins*, 304 U.S. 64 (1938), the Seventh Circuit should have applied Illinois law rather than Delaware law, apparently assuming that, under Illinois law, Stores is not an indispensable party because Illinois allows a minority shareholder to sue the majority shareholder directly. (Pet. at 12-15.) As this Court noted in *Huddleston v. Dwyer*, 322 U.S. 232, 237 (1944), "ordinarily we accept and therefore do not review, save exceptional cases, the considered determination of questions of state law by the intermediate federal appellate courts." Indeed, in the 1980 revision of its rules, this Court "pointedly omitted a long-standing provision . . . that gave certiorari

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5 Alternatively, petitioner argues that the Court of Appeals created a conflict among the circuits by applying a "de novo" standard of review instead of an "abuse of discretion" standard to the District Court's Rule 19 determination. (Pet. at 10-12.) Petitioner did not brief the standard of review to the Seventh Circuit, and the Court of Appeals accordingly did not even discuss the "de novo" and "abuse of discretion" standards. In any event, the Court of Appeals here concluded, correctly, that a corporation is an indispensable party as a matter of law in a shareholder's derivative action. The District Court thus committed reversible error in permitting trial on Count I to proceed, and the Court of Appeals properly expressed no opinion regarding the extent of the District Court's discretion in other contexts.

relevance to a court of appeals decision resolving 'an important state or territorial question in a way in conflict with applicable state or territorial law.' " Stern, Gressman, Shapiro, *Supreme Court Practice*, p. 212 (6th ed. 1986).

There is no reason to depart from that practice here. The petitioner has neither suggested nor demonstrated that the Court of Appeals would have reached a different result had it applied Illinois, rather than Delaware, law in determining whether a claim that the majority stockholder wrongly competed with the corporation is derivative. Moreover, the Court of Appeals expressly ruled that petitioner has waived any claim to the benefit of any state's law other than Delaware by his failure to brief the choice-of-law question issue in either the District Court or the Court of Appeals. (Pet. Appx. 8a.)

Given that the Court of Appeals properly applied the law of Delaware, there is no reason for this Court to grant review of the Court of Appeals' state law determination. The Seventh Circuit correctly interpreted Delaware law, and petitioner does not assert that its interpretation conflicts with any decision of this Court or of another federal appellate court. Consistent with the Seventh Circuit's analysis, *Elster v. American Airlines*, 34 Del. Ch. 94, 100 A.2d 219, 222 (1953), holds that while petitioner may proceed individually against wrongs which inflict a distinct and disproportionate, or "special," injury upon him, he must proceed derivatively where, as in his Count I for breach of fiduciary duty, "the wrong of which [he] complains is not a wrong inflicted upon him alone or a wrong affecting any particular right which he is asserting, . . . but is an indirect injury as a

result of the wrong done to the corporation." No exception to this general rule has been made for closely held corporations. *Abelow v. Symonds*, 38 Del. Ch. 572, 156 A.2d 415, 420 (1959) (a minority stockholder may bring an individual action to enforce common rights running against its own corporation or those dominating it, but must proceed derivatively to remedy wrongs to the corporation itself); *Taormina v. Taormina*, 32 Del. Ch. 18, 78 A.2d 473 (1951) (where action is brought to enforce a cause of action owned by the corporation, action is derivative in nature even though stockholders who are also alleged wrongdoers stand to benefit from it). Because petitioner sought to recover profits lost by Stores, he was required by Delaware law to proceed derivatively and to join Stores as an indispensable party.

CONCLUSION

The petition for writ of certiorari should be denied.

Respectfully submitted,

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Supreme Court, U.S.
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In The Supreme Court of the United States October Term, 1990

EDWARD F. BAGDON,

Petitioner,

v.

THE FIRESTONE TIRE AND RUBBER COMPANY,

Respondent.

REPLY BRIEF IN SUPPORT OF PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

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No. 90-1290

In The
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EDWARD F. BAGDON,

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THE FIRESTONE TIRE AND RUBBER COMPANY,

Respondent.

REPLY BRIEF IN SUPPORT OF PETITION
FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT

Respondent's attempt to support the decision and judgment of the Seventh Circuit fails as much because of what it does not say as because of its misstatements.

I. RESPONDENT CANNOT DISGUISE THE CONFLICT BETWEEN THE SEVENTH CIRCUIT'S DECISION AND THIS COURT'S PRIOR DECISIONS.

Of utmost importance, Respondent has not cited and cannot cite any other case holding, as the Seventh Circuit held here, that "Rule 19 is *not* "applied pragmatically" in derivative cases." The reason why no such case exists (until now) is because this Court explicitly held in *Provident Tradesmens Bank & Trust Co. v. Patterson,* 390 U.S. 102 (1968) that Fed.R.Civ.P. 19 must

be applied pragmatically in all cases, even derivative actions. 390 U.S. at 119. The Seventh Circuit's attempt to create an arbitrary exception to this rule for derivative cases directly contravenes this Court's mandate and is reason enough for granting the petition.

Rather than recognizing that *Provident Tradesmens Bank* is controlling here, Respondent attempts to assert that it does not apply while also contending that the Seventh Circuit somehow complied with its dictates. However, Respondent cannot have it both ways. In the first place, the only question here is whether the parties' corporation is a necessary party under Fed.R.Civ.P. 19 — a question governed by *Provident Tradesmens Bank,* not by the cases cited by Respondent (or the Seventh Circuit) which did not even involve the present version of Rule 19.[1] Second, Respondent's assertion that the Seventh Circuit's decision can be reconciled with *Provident Tradesmen Bank* is ludicrous since the Seventh Circuit never even mentioned that case and *expressly refused* to apply the pragmatic approach mandated therein.

II. RESPONDENT DOES NOT DENY THAT THE SEVENTH CIRCUIT CREATED A SPLIT AMONG THE CIRCUITS.

Respondent also does not dispute that the Seventh Circuit created a split among the Circuits by refusing to accord any deference to the District Court's Fed.R.Civ.P. 19 determiniation that Petitioner's claims were *not* derivative and that the parties' corporation was not a necessary party. Instead, Respondent affirmatively misstates the record in asserting that Petitioner "did not brief the standard of review to the Seventh Circuit",[2]

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[1] Significantly, all of Respondent's cases, including *Ross v. Bernhard,* 396 U.S. 531 (1970) (initially filed in 1965), arose *before* the important 1966 amendments to Rule 19 and this Court's decision in *Provident Tradesmens Bank* which mandated a pragmatic application of Rule 19 with a focus on the realistic analysis of the facts of each case. In *Ross,* the parties never even disputed whether their corporation was a necessary party — only whether plaintiffs were entitled to a jury trial on their derivative claims.

[2] Petitioner extensively briefed this issue to the Seventh Circuit in his motion for rehearing.

as if that somehow excuses the conflict among the Circuits created by the Seventh Circuit's *de novo* review here. As Respondent does not and cannot deny, every other Circuit which has considered the issue has adopted an "abuse of discretion" standard of review.

Respondent's blind insistence on justifying the mechanical rule adopted by the Seventh Circuit here is perhaps the best evidence that the practical and pragmatic application of Fed.R.Civ.P. 19 in *this* controversy could only have resulted only in a finding that the parties' corporation was *not* a necessary party. Indeed, Respondent cannot point to any interest of the parties' close corporation which is separate and apart from those of its two shareholders.[3] As the District Court properly found and Respondent does not deny, complete relief could be granted in the absence of the close corporation, no third party could be prejudiced by any judgment rendered on behalf of petitioner and against respondent, and no threat of multiple litigation existed since all necessary parties were already before the court.

Now, for the first time, Respondent asserts that the Seventh Circuit's finding that Petitioner's claims were derivative somehow eliminated the need for any further analysis as to whether the parties' corporation was a necessary party. Respondent is simply wrong. Petitioner's claims were individual in nature because Respondent breached fiduciary duties which it owed *directly* to Petitioner and inflicted *individual* injuries upon Petitioner not shared by Respondent or the close corporation. But more importantly, even the Seventh Circuit recognized that Petitioner's claims "involve[d] some injury external to the store-corporation" (916 F.2d at 381). Hence, under the undisputed rule in Delaware (and elsewhere), Petitioner should have been allowed to proceed individually since his claims involved both individual and derivative injuries, even assuming the primary injury was to the corporation. *Elster v. American Airlines, Inc.*, 24 Del. Ch. 94, 98-99, 100 A.2d 219, 212 (1953); R. Balotti and J. Finkelstein, *The Delaware Law of Corporations and Business Organizations*, Sec. 13.6, p. 626 (1989 Suppl.).

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[3] Indeed, the close corporation has no practical existence apart from the two shareholders since Respondent abolished the close corporation's Board of Directors after changing the state of incorporation from Illinois to Delaware.

Finally, even assuming, *arguendo,* that Petitioner's claims were completely derivative in nature (which the Seventh Circuit did *not* hold), the Seventh Circuit completely misstated Delaware law as requiring the joinder of the parties' corporation in all cases involving derivative claims. The very case relied upon by Respondent and the Seventh Circuit, *Taormini v. Taormini Corp,* 32 Del. Ch. 18, 78 A.2d 473 (1951), explicitly recognized that a minority shareholder *can* bring derivative claims individually where, *inter alia,* manifest injustice would result or the corporation's rights would not be protected otherwise.[4] *Id.* at 475. This is consistent with the modern rule recognizing that where, as here, the reasons for requiring a shareholder to proceed derivatively are not present, the parties' corporation is *not* always a necessary party.

Thus, under any analysis other than the one rejected by this Court in *Provident Tradesmen Bank,* but adopted by the Seventh Circuit here, this litigation, which has already been tried to conclusion, should have been allowed to proceed without the unnecessary and meaningless joinder of the parties' corporation and then another full trial in state court.

III. RESPONDENT DOES NOT DISPUTE THAT THE SEVENTH CIRCUIT ABUSED ITS APPELLATE JURISDICTION.

Respondent also concedes by silence that the Seventh Circuit made an erroneous and improper factual finding that the parties' corporation was incorporated in Delaware for choice of law purposes, even though it was in fact an Illinois corporation during the operative events giving rise to liability. Instead, Respondent merely argues that this fundamental error somehow did not make a difference. However, the Seventh Circuit's abuse of its appellate jurisdiction caused it to apply Delaware law which in turn led to an erroneous finding that Petitioner's claims were derivative in nature and, therefore, required the joinder of the parties' corporation. However, not only was the Seventh Circuit's view of Delaware law patently erroneous, Petitioner's claims were undoubtedly individual in nature under Illinois law. *Graham v.*

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[4] The Seventh Circuit's failure to follow Delaware law clearly has constitutional implications under the *Erie* doctrine.

Mimms, 111 Ill. App. 3d 751 (1st Dist. 1982); *Zykoych v. Spalding*, 36 Ill. App. 3d 654 (1st Dist. 1976). Moreover, the Seventh Circuit's erroneous application of Delaware law is also clearly contrary to the result which would have occurred under Ohio law, had the Seventh Circuit deferred to the District Court's choice of law determination. *Crosby v. Beam*, 47 Ohio St. 3d 105, 548 N.E.2d 217 (1989).

CONCLUSION

The controversy before this Court is not the petty squabble over the proper interpretation of Delaware law, as Respondent understandably attempts to paint it. Rather, it concerns a Seventh Circuit decision that directly conflicts with, indeed flaunts, this Court's precedent, creates a conflict among the Circuits and involves a fundamental abuse of its appellate jurisdicition. The result is unjust and elevates form over substance to waste judicial resources by forcing a retrial in state court. For all of the above reasons and the reasons set forth in his initial brief, Petitioner, Edward F. Bagdon, respectfully requests that this Court grant his petition for a Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit and enter an Order reversing the Seventh Circuit's dismissal of his cause for failure to join a necessary party.

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